Minutes of the Executive Board's Monetary Policy Meeting, No.6

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TIME: 9 a.m.

PRESENT: Stefan Ingves, Chairman
Karolina Ekholm
Lars Nyberg
Lars E.O. Svensson
Barbro Wickman-Parak
Svante Öberg

Leif Pagrotsky, Vice Chairman of the General Council

Sigvard Ahlzén
Hanna Armelius
Claes Berg
Hans Dillén
Charlotta Edler
Heidi Elmér
Johanna Fager Wettergren (§§1-3)
David Forsman (§§1-3)
Eric Frieberg
Jesper Hansson
Mia Holmfeldt (§1)
Ann-Christine Högberg
Martin W Johansson (§1)
Anna Lidberg (§1)
Tomas Lundberg (§ 1-3)
Pernilla Meyersson
Marianne Nessén
Staffan Viotti

§ 1. Economic developments

It was noted that Hanna Armelius and Hans Dillén would prepare the necessary draft for monetary policy meeting minutes with regard to paragraphs 1, 2 and 3 on the agenda for the meeting.

Mia Holmfeldt of the Financial Stability Department began by presenting the development of the Riksbank's international stress index, which is an aggregated measure of stress on the monetary, bond and stock markets. This is now at a relatively low level but still somewhat above the historical average calculated for the period 1997 to 2007. The so-called TED spread is actually below its historical average, mainly thanks to the measures taken by the central banks and other authorities.

All of the components in the Swedish stress index have increased somewhat recently. This is partly a result of the concern about developments in, for example, Dubai and Greece.

State support for financial institutions in Sweden remains extensive. The Riksbank's three fixed-rate loans for monetary policy purposes in June, September and October constitute approximately three-quarters of the Riksbank's volume of outstanding loans. These loans will fall due in the summer and early autumn. Since the beginning of November, the Riksbank's outstanding loans have consisted exclusively of SEK loans as all the USD loans have now matured.

Anna Lidberg of the Monetary Policy Department reported on developments in the financial markets since the Executive Board Meeting on 9 December. The US central bank, the Federal Reserve, has announced that it will extend the Troubled Asset Relief Programme and that the losses from this programme are now expected to be lower than previously. The British central bank, the Bank of England, has announced that the programme for the purchase of securities will continue but will not be expanded. The central banks in New Zealand and Switzerland have decided to leave their policy rates unchanged, although the Reserve Bank of New Zealand is now signalling that policy rate increases may come earlier than previously indicated.

The interest rate differential between Greek and German government securities with a maturity of 10 years has risen significantly over the past week. The krona has weakened somewhat, probably as a result of the turmoil on the markets in Greece and Dubai.

New monthly data on housing prices from Mäklarstatistik shows a slight decline in Sweden as a whole, but there are considerable regional variations.

There has been a slight downward shift in expectations regarding monetary policy. The market is now pricing an interest rate increase that lies a little further ahead than previously, which means that expectations are drawing closer to the Riksbank's repo rate path in the short term. In the slightly longer term, expectations are now somewhat more below the repo rate path than previously. Market reports indicate that the analysts expect today's decision to entail an unchanged repo rate and an unchanged repo rate path and that no new fixed-rate loans will be offered.

Jesper Hansson of the Monetary Policy Department presented a summary of the background material for the Executive Board's discussion. He noted that underlying material in the form of assessments of economic developments in Sweden and abroad had been discussed at the Executive Board meeting held on 9 December. Since then, new statistics have become available on industrial production in Sweden, which was weak, and on order intake, which was positive. A new outcome for CPI inflation has also become available and this was in line with the forecast. Finally, the outcome for third-quarter growth in Japan has been revised downwards from almost five per cent to just over one per cent calculated as an annual rate.

The confidence indicators have continued to rise since October, but the rate of increase is no longer as high and some indices have actually fallen. Industrial production was weak in October in both the euro area and Sweden. The outcomes for GDP in the third quarter in both Sweden and abroad were in line with the Riksbank's forecast. Employment in Sweden, on the other hand, has developed somewhat more strongly than forecast in September and October. The oil price is now higher than previously during the autumn.

To sum up, it can be said that although the recovery of the global economy is continuing but there is still plenty of spare capacity, which means that inflationary pressures are low. CPIF inflation will be close to two per cent at the end of the forecast period.

Since July, the forecasts for the level of GDP in Sweden and abroad for 2012 have been revised upwards by approximately three per cent. Despite this, resource utilisation will remain low throughout the forecast period and the forecast for unemployment has only been revised downwards by slightly less than one per cent since July. At the same time, the inflation forecast has been revised downwards since July, mainly as a result of the forecast of a stronger krona, a lower forecast for inflation abroad, low wage pressures and slightly low rental costs than expected. In the main scenario of the draft Monetary Policy Update it is therefore proposed that the repo rate should remain at 0.25 per cent and later be raised to more normal levels, starting in the autumn of 2010. This means that the repo rate path adopted in October remains unchanged.

§ 2. Economic outlook abroad

First Deputy Governor **Svante Öberg** said that he shared the view of developments abroad presented in the draft Monetary Policy Update. The financial markets continue to improve. GDP growth is expected to be slow in the euro area but somewhat stronger in the USA. Price and wage increases will be kept down by low resource utilisation. Asia has coped relatively well with the financial crisis and is expected to experience high GDP growth. However, problems remain in the Baltic countries, and particularly in Latvia.

The revisions compared with the forecast in October are marginal. The current forecast entails slightly stronger GDP growth in 2010 but somewhat lower inflation in 2011 and 2012. There is considerable uncertainty about the strength of the recovery. It is clear that the international recession has bottomed out. However, the upturn in the period immediately ahead will partly be driven by temporary factors such as the effects of highly expansionary fiscal and monetary policies and an inventory cycle. There is therefore a risk that growth will be dampened again when the stimulating effect of these temporary factors declines.

Deputy Governor **Lars E.O. Svensson** declared that he shared the view of developments abroad contained in the draft Monetary Policy Update. However, he wished to emphasise that even though the recovery of the global economy is continuing and the situation on the financial markets has improved somewhat since October, there is still a need, as in October, for an expansionary monetary policy in Europe and the USA. The risks associated with breaking off the expansionary monetary policy too early are still much greater than the risks of continuing to pursue it for too long.

Deputy Governor **Karolina Ekholm** said that she too shared the view of the international economic outlook presented in the draft Monetary Policy Update. However, she saw a number of risks relating to developments in the period ahead. While the emerging economies in Asia and Latin America are exhibiting relatively good growth, the industrial countries in Europe and North America are still showing low growth. The fact that different parts of the global economy are developing differently leads to certain problems that affect monetary policy.

Large capital inflows to several of the emerging economies have been reported. These inflows tend to push up the prices of various assets – rising housing prices have, for example, been reported in several Asian countries. At the same time, the experience gained during the Asian crisis of the 1990s indicates that these flows can change direction abruptly, which creates a risk of considerable falls in asset prices at some point in the future.

A factor that contributes to these capital inflows is the difference between interest rate levels in the "old" industrial countries, which are maintaining low interest rates to support the recovery of their economies, and in these emerging economies. The low interest rates in, for example, the USA, make it profitable to borrow dollars in order to invest in other currencies that provide a higher return at given exchange rates. Several of the countries that are now experiencing capital inflows are unwilling to allow their currencies to appreciate against the US dollar despite the fact that the inflows are creating appreciation pressures. This is understandable in the light of the experience of the Asian crisis. Exchange rates can be come highly volatile if they are completely adapted to highly volatile capital flows. However, it is also probable that the unwillingness to allow the exchange rate to appreciate strengthens the tendency towards capital inflows as it means that those that invest money in this way can not only make money on the difference between the interest rate for dollar loans and the return on the assets they invest in, but may also gain from a fall in the value of the dollar loan relative to the value of the assets if the currency nevertheless appreciates against the dollar.

Ms Ekholm said that it is difficult to say what the consequences of the capital flows we are now seeing will be for the development of the global economy in the period ahead, but there is a risk that new imbalances will be generated. Development in the economies that are now doing rather well may be affected in the future either by tendencies towards asset bubbles or appreciating currencies , which would have a negative impact on their competitiveness. In the case of the future development of the "old" industrial countries, we can expect that it will be affected by the need to consolidate government finances, which have deteriorated greatly during the recession. All in all, this entails a number of risks to development abroad in the period ahead.

Deputy Governor **Lars Nyberg** noted that the financial markets have continued to stabilise and have demonstrated their ability to cope with shocks such as those from Dubai or Greece with no significant negative effects. This is a sign of strength as sensitivity to shocks can be a source of anxiety. At the same time, the spreads have decreased further and access to various markets has increased. The market for securitised mortgages has opened cautiously and it has also been possible to conduct several private equity funding operations. The development of the financial markets has thus continued to be clearly positive since the previous monetary policy meeting. However, in the banking system there are still significant holes in the balance sheets that have to be filled with new capital.

Mr Nyberg said that in all essentials he shared the view of the real economy presented in the draft Monetary Policy Update. Compared to the situation in July, there is a significant upward adjustment of the forecasts for the global economy. There has been an upturn in world trade following the dramatic decline of the previous autumn and winter. Since the previous monetary policy meeting, growth in the USA and Europe has slowly increased, approximately as expected. The continuing surprise is primarily the growth in Asia and in Brazil. This will provide more of a boost to the economic upturn than expected just a few months ago, which will have positive effects in both the USA and Europe. So far, however, these effects are relatively limited. It appears, however, that the downturn in Asia and parts of South America will be much shallower and shorter than feared.

The downside of this development and of the liquidity injections that the central banks of the world have given to the markets – is that considerable capital flows are moving to the emerging economies partly, but not solely, in the form of so-called carry-trades. This drives up assets prices and tends to create bubbles, not least on the housing and commercial property markets. Exchange rates are also pushed up, unless they are fixed against the dollar, which affects the profitability of the export industry. However, capital flows of this type may disappear very quickly, as many Asian countries learned during the previous crisis. Increasing concern about how the strong capital flows may affect the real economy is therefore justified.

Governor **Stefan Ingves** supported the assessment of the economic outlook abroad contained in the draft Monetary Policy Update and declared that he did not intend to repeat the analysis presented there. Mr Ingves instead chose to highlight various risks. The recovery is based on an expansionary economic policy. This entails a number of difficult considerations. There is still a lot of uncertainty about the stability of the recovery.

It usually takes a long time before all the effects of a financial crisis stop dampening the real economy. This applies, for example, to the effect of lower house prices in countries where there were considerable increases in house prices before the crisis. It also applies to unemployment which tends to remain at high levels in connection with a financial crisis. In addition, there is the risk that the financial crisis entails a downturn in potential production. Such a development could be observed in connection with the crises in Sweden and Asia in the 1990s, and according to the IMF there is a clear risk that this could now happen again in several countries.

In the euro area, lending to both households and companies is close to zero and all the bank problems are not over. At the same time, various support measures are being phased out which means that an increasing number of banks must manage their funding on their own or be restructured in one way or another. This indicates that the supply of credit will continue to be subdued and that the recovery will be prolonged. In the USA, the percentage of problem mortgages is now approximately 10 per cent and this figure is rising quickly. In addition, it is expected that many small and medium-sized companies will continue to experience problems, which will also impede the recovery. One sometimes talks about "jobless growth", but in both Europe and the USA one can now talk about "loanless growth".

Expansionary fiscal policies have led to a rapid increase in the national debts of many countries. These countries can not continue to pursue expansionary fiscal policies much longer. This will lead to a lower stimulation of demand and possibly to rising long-term interest rates, both factors that will slow down the recovery.

Mr Ingves also took up the issues of global imbalances, capital flows and carry-trade that Ms Ekholm had discussed earlier. He agreed with her that such developments can lead to dramatic fluctuations in capital flows and to the problems associated with such fluctuations.

These risks should be weighed against the fact that the global economy and the financial markets are now functioning much better than they were a year ago. However, the problems are not over and new problems have arisen. Against this background, it is reasonable to assume that there will be moderate global growth, low inflationary pressures and significant negative production gaps in many areas.

Deputy Governor **Barbro Wickman-Parak** said that she shared the view of the risks associated with global imbalances and capital flows to the emerging economies that had been highlighted by several of her colleagues on the Executive Board. She said, however, that she did not intend to discuss this further but chose instead to comment on the economic outlook abroad in the shorter term.

Ms Wickman-Parak continued by noting that she has long held a more positive view of the potential for growth internationally and that she therefore welcomed the upward adustment of the figures for growth abroad in the latest forecasts. Compared with the summer, this represents a significant change. The picture of a considerable fall this year remains, but this will not be quite as severe as the forecast in the summer indicated. It is more important that the figures for growth next year now look much brighter. For example, in the summer the Riksbank estimated that the GDP of Sweden's most important trading partners would remain largely unchanged in 2010. The forecast now is that growth in 2010 will be approximately 1.5 per cent and the figure for 2011 has also been adjusted upwards slightly compared with the forecast in July.

Compared to October, the forecast for the USA remains the same for next year and for 2011. Ms Wickman-Parak's assessment was that growth will be somewhat higher than this next year. This in turn will have repercussions in the euro area and other parts of the world. Ms Wickman-Parak pointed out that on several previous occassions she has underlined the importance of the fact that the housing market in the USA has strengthened in terms of sales, prices and housing stock. This development has continued and during the third quarter housing investments increased after having fallen continuously for three and a half years. One should not make too much of a single quarter, but it is a reasonable assessment that the construction of housing will provide a growing contribution to GDP in the period ahead.

Other positive statistics have also been received from the USA recently. As was already known, household consumption increased in the third quarter of this year, although a large part of the increase was due to temporary rebates for the purchase of new cars. But retail sales also continued to increase steadily in October and November even though the rebates are no longer available. However, one of the most positive factors is the considerable improvement in the figures for the labour market. The most recent figure, that for November, was a very positive surprise. Employment in November fell by only 11 000. These figures are revised often so figures for individual months should be interpreted with caution. But if one looks at the last three months one can see that employment fell by an average of approximately 85 000 jobs per month. In the first quarter of this year, an average of almost 700 000 jobs were lost per month. It is worth noting that the number of temporary employees has increased dramatically in recent months. This is usually a very good indicator of a future increase in regular employment.

The current development of the labour market is pretty much in line with previous experience. On average, there is usually a time lag of one to two quarters between GDP growth and an increase in employment. In this downturn, employment has fallen more in relation to GDP than has been the case in previous downturns. This suggests that there will be a more rapid return to increased employment. The level of productivity has been sustained relatively well and increased significantly in the past quarter. It is probable that any further productivity gains will be limited. This is also indicated by the fact that the recession that the global economy has now emerged from was not preceded by any strong upturn in corporate investment and that such investment has since fallen sharply so that the investment ratio has fallen to an historically low level.

Ms Wickman-Parak's assessment was that employment in the USA will increase during the course of next year, which will provide a welcome boost to private consumption. This is important given that one can not expect to see any loan-financed consumption like that seen before the crisis. So, in conclusion, she said that although she agreed with the main features of the forecast in the Monetary Policy Update, her assessment was that forecast for growth abroad is slightly too low, above all for next year.

Governor **Stefan Ingves** summed up the discussion of the international economic outlook by saying that the Executive Board essentailly supports the assessment presented in the draft Monetary Policy Update. The global economy is recovering and the functioning of the financial markets is improving, but there are significant risks associated with this assessment.

§ 3. Economic developments in Sweden and the monetary policy discussion

First Deputy Governor **Svante Öberg** began by saying that he shared the view of developments in Sweden presented in the draft Monetary Policy Update. Good GDP growth is expected in the period ahead, but resource utilisation will nevertheless be low and underlying inflation will be just under 2 per cent for most of the forecast period. Mr Öberg said that he also supported the proposal to leave the repo rate unchanged and the repo rate path presented in the draft Monetary Policy Update.

The revisions are marginal compared to the forecasts in the Monetary Policy Report of October. The figure for GDP throughout the forecast period is the same, the forecast for the labour market is slightly more positive while there is a slight downward adjustment of the figure for inflation. There is therefore no reason to change the assessment of the direction of monetary policy made in October.

Mr Öberg did, however, wish to comment on the situation in the business cycle. Although it is clear that the recession has bottomed out in Sweden too, the upturn is still weak. After a fall in GDP of over 6 per cent between the first quarter of 2008 and the first quarter of 2009, GDP increased by a total of 0.5 per cent in the second and third quarters of this year.

A divided economy is now apparent with a much worse situation in the industries that are dependent on exports than in the service sector. Industrial production has fallen much more than the production of services. As yet, no stable upturn has been seen in production in either the manufacturing industry or the service sector.

There is also considerable uncertainty about the strength of the upturn in the period ahead. It is reasonable to assume, as in the draft Monetary Policy Update, that GDP growth will be rather good over the next few years. But it still remains to be seen how sustainable the recovery is. In Sweden too, the upturn in the period ahead will partly be driven by temporary factors such as highly expansionary fiscal and monetary policies and an inventory cycle. The forecast also assumes that the world market will grow strongly, that private consumption will increase at a good rate despite the fact that the development of household incomes will be weak, that employment will continue to increase in the public sector and that there will be a significant increase in investment despite a low level of capacity utilisation and weak profitability. This may turn out to be too optimistic.

Resource utilisation will be low during the forecast period despite the fact that the Riksbank's assessment is that GDP growth will be fairly good. This will still be the case even if growth proves to be somewhat higher. The development of prices and wages will therefore be slow. It is anticipated that unit labour costs, which have risen by approximately 5 per cent per year in the last three years, will remain largely unchanged over the next three years. It is believed that the krona will continue to strengthen. This means that inflationary pressures will be low during the forecast period, and perhaps even lower than the Riksbank has calculated.

Deputy Governor **Lars E.O. Svensson** began by saying that he shares the view of economic development in Sweden presented in the draft Monetary Policy Update, but he maintained that a lower repo rate path than that presented in the main scenario would lead to better outcomes for inflation and resource utilisation.

Flexible inflation targeting aims both to stabilise inflation around the inflation target and to stabilise resource utilisation at a normal level. As the parliamentary Committee on Finance said in 2007 in its comments on the evaluation of monetary policy in the period 1995-2005 by Francesco Giavazzi and Frederic Mishkin(2006/07:FiU27): "The Committee believes that Swedish monetary policy should be conducted in a flexible way and should aim to stabilise the development of inflation as well as that of employment and production." In parenthesis, it can be noted that nothing is said about stabilising the interest rate or about avoiding very high or very low interest rates.

The issue is to determine a repo rate path that provides a "well-balanced" monetary policy. If there is a conflict between stabilising inflation and stabilising resource utilisation, then a well-balanced monetary policy is a reasonable compromise between the stability of inflation and the stability of resource utilisation. If there is no such conflict, things are much simpler. Then it is merely a question of finding the repo rate path that will stabilise both inflation and resource utilisation. In the current situation, as in October, it can actually be claimed that there is no conflict.

This draft of the Monetary Policy Update contains a main scenario with a repo rate path that agrees with the main scenario in the October Monetary Policy Report, that is, it has a repo rate of 0.25 percentage points up to autumn 2010. This gives a forecast for CPIF inflation that is below the inflation target during the forecast period and a forecast for resource utilisation that is very low and will remain low throughout the forecast period. Mr

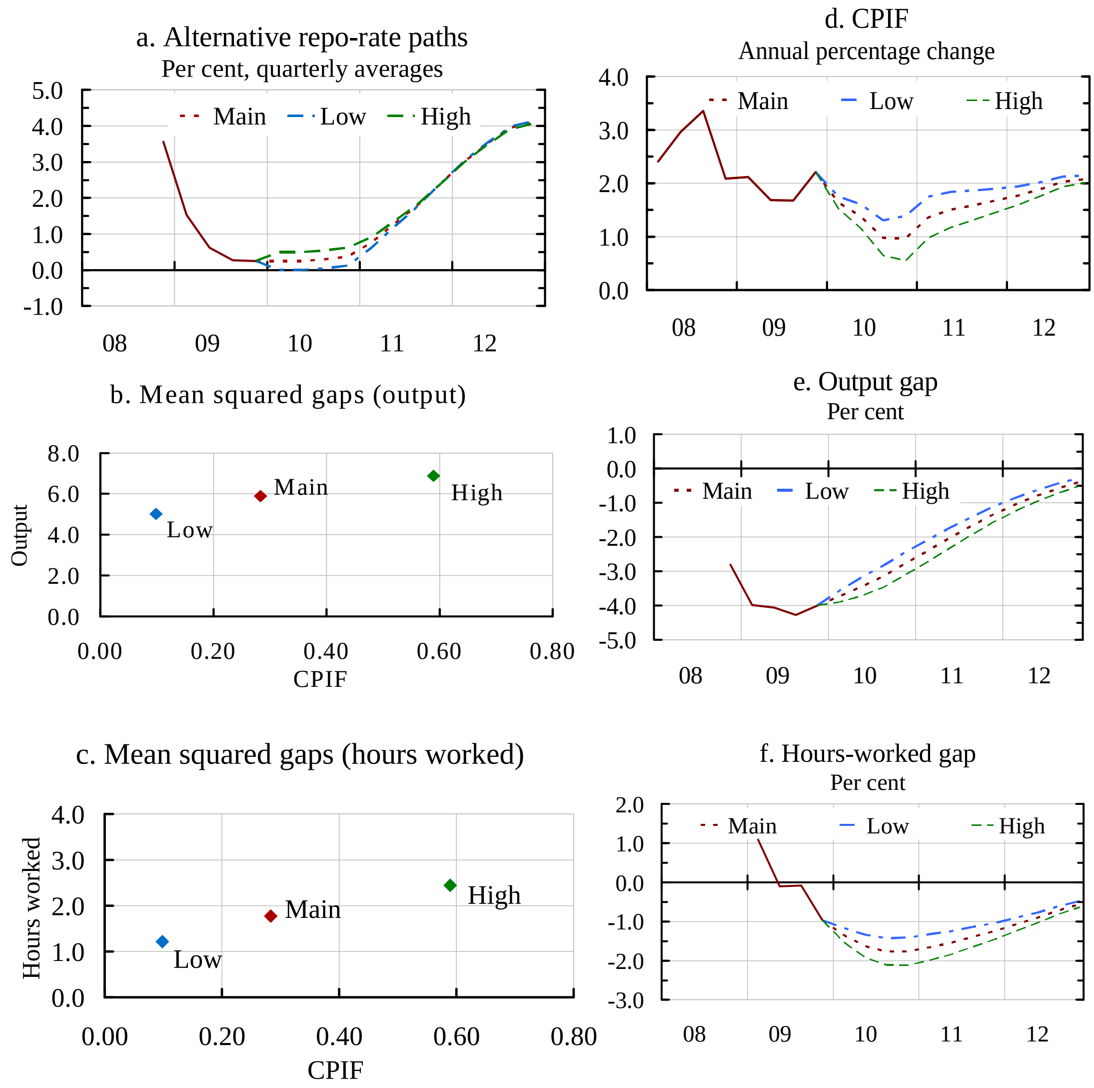
Svensson asserted that a lower repo rate path than that in the main scenario would better stabilise both inflation and resource utilisation.

Monetary policy has a major impact on both inflation and the real economy. The Executive Board bears a considerable responsibility for its decisions and their consequences for inflation and the real economy. It is important that the Riksdag, the Committee on Finance and external analysts can examine and evaluate monetary policy and assess whether the Executive Board has made the right decision and whether monetary policy is well balanced. As the Committee on Finance says in the comments mentioned above: "A flexible monetary policy requires, in the Committee's view, a high degree of transparency and that the Riksbank is very clear about why the various repo rate decisions have been made. This is also a prerequisite for the possibility to examine and evaluate monetary policy."

In order for the Riksbank to be able to be "very clear" about why the various repo rate decisions have been made it is necessary, according toMr Svensson, to discuss and assess various possible monetary policy alternatives and their consequences for inflation and the real economy. A specific decision can best be justified by comparing it to the alternatives. It is thus a question of clarifying what reasonable and possible repo rate paths are available and what consequences these alternatives paths have on the forecast for inflation and resource utilisation.

The Monetary Policy Reports normally contain alternative repo rate paths (scenarios) with the corresponding alternative forecasts for inflation and the real economy. To date, the Monetary Policy Updates have not included any alternative repo rate paths. They contain only one repo rate path, the main scenario, and the corresponding forecast for inflation and the real economy. However, without alternative repo rate paths it is not possible to assess whether the Executive Board has made the right decision. Mr Svensson therefore maintained that alternative repo rate paths and corresponding forecasts should also be presented in the Monetary Policy Updates. As he maintained that alternative repo rate paths are necessary for a correct assessment of whether monetary policy is well balanced, he wished to include graphs that present monetary alternatives in the minutes (Figure 1).

Figure 1. Monetary policy alternatives, December 2009



Sources: Statistics Sweden and the Riksbank

These graphs show the consequences of alternative repo rate paths for the forecast for inflation and resource utilisation. They also show the so-called mean squared gap that was introduced in an article in the latest Monetary Policy Report. The mean squared gap for inflation measures the gap between the inflation forecast and the inflation target or, more precisely, the mean squared deviation between the inflation forecast and the inflation target during the forecast period. A lower mean squared gap for inflation entails a better achievement of the inflation target, that is a better stabilisation of inflation around the inflation target. The mean squared gap for resource utilisation, measured as the output gap or the hours gap, measures the deviation between the forecast for resource utilisation and normal resource utilisation. A lower mean squared gap for resource utilisation entails a better stabilisation of resource utilisation around a normal level.

The alternative forecasts for inflation and resource utilisation have, as usual, been calculated using the Riksbank's model Ramses. In particular, they have been calculated using so-called anticipated deviations from the main scenario's repo rate path. This corresponds to a situation in which the Riksbank clearly and transparently announces an alternative repo rate path that it intends to follow and that affects market expectations and thus inflation and the real economy.

One can also calculated the alternative forecasts for inflation and resource utilisation using so-called unanticipated deviations from the main scenario's repo rate path. This corresponds to the strange situation in which the Riksbank misleadingly announces the main scenario's repo rate path but plans in the subsequent monetary policy decisions to surprise the market and the economic agents by deviating from the announced repo rate path. This would be the opposite of the transparent and clear monetary policy that the Riksbank says it conducts and should conduct. It is therefore reasonable to calculate the alternative forecasts for inflation and the real economy on the basis of anticipated deviations from the main scenario The effects of anticipated deviations are somewhat greater than the effects of unanticipated deviations.

The deviations from the main scenario's repo rate path that are shown in these graphs entail a reduction or an increase in the repo rate by 0.25 percentage points over four quarters. After this, the alternative repo rate paths gradually return to the main scenario's repo rate path in accordance with the Riksbank's estimated historical reaction function.

A reduction of the repo rate by 0.25 percentage points for four quarters leads, all else being equal, to an increase in inflation of just over 0.4 percentage points, a decrease in the real interest rate of 0.7 percentage points, an increase in output and the output gap of just over 0.4 percentage points and an increase in the number of hours worked by approximately 0.35 per cent. If employment varies one-to-one with hours worked, employment will thus also increase by 0.35 per cent.

0.35 per cent of an estimated potential employment rate of, conservatively, 93 per cent of a labour force of approximately five million is equivalent to over 16 000 jobs. Calculating on the basis of 93 per cent thus entails assuming a rather high figure for long-term unemployment of 7 percent. An increase of over 16 000 jobs is thus not very far from the middle of the range of 10 000 to 25 000 jobs saved that Mr Svensson mentioned at the Monetary Policy Meeting in October. To sum up, a reduction of the repo rate path by 0.25 percentage points over four quarters will thus give, all else being equal, an increase in inflation of just over 0.4 percentage points and, if employment varies one-to-one with hours worked, an increase in employment of approximately 0.35 per cent, which is equivalent to over 16 000 jobs.

These figures and the estimated effects of a repo rate reduction are not the final word. Of course the future will bring further developments of Ramses and other models, more empirical estimates and new experience that will lead to the revision of these figures. However, these figures are the *latest* and *best* word on the basis of the information and knowledge currently available, and therefore provide the best basis for a decision now.

Similarly, the mean squared gaps are perhaps not the last word when it comes to measuring the Riksbank's target achievement. However, it is fair to claim that they provide the best measure of target achievement found so far, that is the extent to which the Riksbank has succeeded, in the words of the Committee on Finance, in "stabilising the development of inflation as well as that of employment and output."

If the main scenario's repo rate path constitutes a well-balanced monetary policy, it should be possible to show that a higher or lower repo rate path will, overall, lead to a poorer stabilisation of inflation and the real economy than the main scenario. Mr Svensson asserted that the enclosed figure is clarifying in this context. It shows that the lower repo rate path provides both a higher forecast for CPIF inflation that is closer to the inflation target (which is shown in panel d) and a higher forecast for resource utilisation measured in terms of the output gap (panel e) or the gap for hours worked (panel f), which even with the lower repo rate is low but not as low as in the main scenario. As in October, a lower repo rate path than in the main scenario thus stabilises both inflation and resource utilisation better.

In panel b, which shows the mean squared gaps for output and inflation, it can be seen that the lower repo rate path leads to a lower mean squared gap for both inflation and output. Compared to October, the difference for inflation is now much greater, so the figures for both inflation and resource utilisation favour the lower repo rate path. In panel c, which shows the mean squared gaps for hours worked and inflation, the same results can be seen, that is that a lower repo rate path is better, when one uses the hours gap as a measure of resource utilisation. Mr Svensson emphasised once again that, if hours and employment vary one-to-one, then the lower repo rate path may result in over 16 000 saved jobs. This is a mean forecast; the actual number of jobs saved may be higher or lower. Mr Svensson said, however, that the number should be within the range of 10 000 to 25 000 jobs that he mentioned in October.

Against this background, Mr Svensson advocated the lower repo rate path shown in the figure, in which the repo rate is cut by 0.25 per cent to zero and held 0.25 per cent lower than in the main scenario to the end of the third quarter of 2010 and then gradually returns to the main scenario's repo rate path.

Can reducing the repo rate to zero lead to problems? No, there is nothing to indicate that this would lead to problems for the financial markets. Mr Svensson said that as recently as in October he pointed out that all the information indicates that the financial markets can handle zero interest rates, or even negative interest rates, without problems. Since then, the situation on the financial markets has improved further and has begun to normalise. The repo rate has been at 0.25 per cent since July. The tomorrow-next interest rate has been down at 0.15 procent and in some instances even lower. The USA, Switzerland and Japan have even lower interest rates without this causing any problems for the financial markets. The USA now has a range of between 0 and 0.25 per cent for the federal funds rate and in Switzerland the repo rates have been as low as 0.02 per cent. In Japan, the policy rate has long been 0.10 per cent. The profit and loss accounts of the Swedish banks show that their earnings are good, and they would be able to handle a lower repo rate without difficulty. The increase in liquidity, better development of the real economy and weaker krona that would follow in the wake of a lower repo rate should entail a lower level of credit risk in the banks' lending to households and companies and thus make the banks' loan portfolios safer. In line with this, the value of bank shares normally increases when policy rates decrease. A lower repo rate path would thus improve financial stability. If, contrary to expectations, a particular financial market does experience problems, this must be weighed against the over 16 000 jobs that can be saved and against the better achievement of the inflation target.

One possibility is that the real economy may improve more quickly than predicted in the Riksbank's forecast. However, this is not an argument against a lower repo rate path.

Although a better development of the real economy would result in resource utilisation being somewhat higher during the forecast period, it would still be lower than normal and unemployment would still be higher than normal. It is not likely that the real economy could improve so quickly that the Swedish economy would become overheated or that CPIF inflation would overshoot the target. If such tendencies were nevertheless to arise, it would be possible to detect them in time and there would then be no limit to how quickly the repo rate path could be raised to counteract an overheating.

However, in order to best determine which repo rate path is well balanced in the event of a better development of the real economy, one needs to see alternative repo rate paths like those in the enclosed figure, with forecasts for inflation and resource utilisation that are calculated under the assumption of a more positive development of the real economy.

Deputy Governor **Barbro Wickman-Parak** noted that the repo rate path in the draft Monetary Policy Update is unchanged compared with the forecast in October. The changes in the growth forecasts are relatively small and it is only with regard to the labour market that a more noticeable change for the better has taken place. At the same time, the inflation forecast has been adjusted downwards as a result of the downward adjustment of the figure for inflation abroad and a stronger forecast for the exchange rate, and in light of the fact that rent increases are expected to be lower next than predicted previously. This is the picture that emerges when one looks at events over the last few months.

Ms Wickman-Parak said that for her it was more natural to compare with what has happened throughout the entire period the repo rate path has remained unchanged, that is since July. She reminded the meeting that she had already pointed out that there has been a rather significant upward revision of the figure for growth abroad. In the case of Sweden, it is estimated that GDP will increase by 2.5 per cent in 2010, that is approximately 1.5 per cent more than predicted in the summer. This increase will also start from a slightly higher level as it is estimated that the fall in GDP this year will be approximately one percentage point less than forecast in the summer.

The same applies to employment; the change will begin from a slightly higher level than previously predicted and development in the period ahead will be stronger than previously predicted. It is now calculated that the fall in employment this year, measured in hours worked, will be 2.5 per cent compared to the figure of 3 per cent in October and of almost 4 per cent in the summer. It is predicted that the fall in hours worked will slow down to 1.3 per cent next year, which is an improvement of over one percentage point compared with the forecast in the summer.

As can be seen in the draft Monetary Policy Update, cost pressures measured in terms of unit labour costs increased by almost 6 per cent in 2008. For 2009 as a whole, unit labour costs are expected to increase by almost 5 per cent, which is approximately one percentage point higher than the forecast in July. Over the next two years, it is estimated that productivity will recover and that unit labour costs will fall slightly more than predicted in the summer. However, viewed over the entire three-year period 2009-2011, cost pressures will increase somewhat more than estimated in the summer.

International inflation affects the level of imported inflation in Sweden. Compared to October, the figure for international inflation has been adjusted downwards by around two-tenths of a percent for 2011. However, compared to the summer it is higher for 2010 and approximately the same for 2011. It can also be mentioned that the forecast for the oil price is now higher compared to the forecasts in both October and July.

On point after point, the forecasts have been adjusted in a way that would justify a higher inflation forecast and thus a higher repo rate forecast compared with July when the current repo rate path was adopted. It is reasonable to assume that lower rent increases should reduce the inflation forecast for next year but the major difference is based on the forecasts of a stronger krona in 2010 and 2011. Ms Wickman-Parak said that she intended to return to this.

She pointed out that at the previous meeting her view was that both private consumption and exports would make a greater contribution to growth and she welcomed the upward adjustments in the forecasts that have now been made. She added that her assessment was, however, that exports can still make a greater contribution to growth than indicated in the forecast. Upward adjustments may also be required in the period ahead with regard to the labour market.

The stronger krona has an impact on the inflation forecast but also on the forecasts for imports and exports. Ms Wickman-Parak said that one of the lessons learned from experience is that one should not attach too much importance to this variable as the accuracy of the forecasts is not usually of the highest order. It can be noted, however, that the cost level is high in the initial position, that the companies' profits are under pressure and that stronger demand may lead the companies to push up their margins by increasing prices. Although this is not imminent, it is the inflation forecast in the longer term that is important. As mentioned on previous occasions, increases in commodity prices also constitute a risk of future inflation. Handling such price impulses becomes more difficult if there is a strong upward pressure on domestic market prices at the same time.

Ms Wickman-Parak said that during the course of the crisis she has had no problem in supporting rapid cuts that have brought the repo rate down to extremely low levels, on the contrary. But the aim has been to begin an upward adjustment when economic activity starts to return to normal. This is happening now, and the time for gradual increases is approaching. Ms Wickman-Parak emphasised that she has had a more positive view of the outlook for growth and she feels that she is supported in this view by the current development of the economy.

Ms Wickman-Parak then said that she agreed that the future upturn will start from a low level and that inflation is not a problem at the moment, and she therefore supported the proposal to leave the repo rate unchanged at 0.25 per cent for a time. On the other hand, she intended once again to enter a reservation against the repo rate path.

The repo rate is at an extremely low level and she was of the opinion that gradual increases at an earlier stage were preferable. Household borrowing has increased and consumption is increasing. This is good and has been needed to get demand moving. But borrowing is now increasing at a faster rate and an increasing number of borrowers are taking loans at variable interest rates. Gradually increasing the repo rate will make it possible for the households to gradually begin adapting their borrowing. If instead borrowing is inflated even further, then the impact on demand may be even greater when the repo rate increases do come. Ms Wickman-Parak therefore advocated that the increases in the repo rate should begin sooner. This would then mean that the repo rate path would not need to be as steep as the proposed path. She said that with the information available this would be a well-balanced monetary policy that would create stability in demand at the same time as inflation would stay close to the target.

Deputy Governor **Karolina Ekholm** began by saying that she shared the view of developments in Sweden presented in the draft Monetary Policy Update. As at the previous monetary policy meeting, the forecast includes revisions that have counteracting effects on the decision itself. On the one hand there has been a slight upward revision of the forecasts for GDP and resource utilisation, which would indicate a need for a somewhat tighter monetary policy. But at the same time there has been a downward revision of the forecast for inflation, which would indicate a need to ease monetary policy. The question then is what the net effect of these counteracting tendencies will be in terms of what is a well-balanced monetary policy. Ms Ekholm said that her view is that in principle they cancel each other out and that it is therefore justified to keep the repo rate at its current level and to retain the forecast for the future repo rate that the Riksbank has had since the monetary policy decision in July.

In the case of the downward revision of the inflation forecast, Ms Ekholm said that she shared the scepticism of Ms Wickman-Parak to some extent. The downward revision is due to a number of different factors, but one important factor is a new assessment of the development of the exchange rate where it is now estimated that the krona will develop somewhat more strongly than previously assumed. Like Ms Wickman-Parak, Ms Ekholm was inclined to attach little importance to the estimate of a stronger krona as it is so difficult to forecast the exchange rate. The forecasts that the Riksbank has produced for the exchange rate of the krona since the exchange rate was allowed to float have often indicated that the krona would strengthen. Typically, however, this strengthening has only materialised in periods preceded by a substantial weakening of the exchange rate for the krona, as in the periods 2002-2003 and 2006-2007. The fact that the krona has still weakened in TCW terms in relation to its value before the crisis took a serious hold last autumn does actually indicate that it should strengthen somewhat in the period ahead. However, the expectation that the krona will now strengthen more than was expected in October, which is partly based on the fact that interest rates are now expected to be somewhat lower abroad, represents a revision of the forecast that Ms Ekholm said she attaches relatively little importance to and that she believes to be highly uncertain.

At the same there are other factors that indicate a downward revision of inflation, such as the expectation that rent agreements will entail low rent increases next year, which will have some effect, and the fact that it appears to be reasonable to expect a lower level of inflation in the euro area in 2011 and 2012 than previously estimated by the Riksbank. With an unchanged repo rate path, it can be expected that the real repo rate will be higher than expected in October due to a lower rate of inflation (which is shown in Figure 9 in the draft Monetary Policy Update). This entails a somewhat tighter monetary policy, which may be justified in the light of the upward revision of the GDP forecast. However, the fact remains that resource utilisation is very low and there are therefore good reasons for conducting a highly expansionary monetary policy in order to contribute to the recovery as long as this is possible without threatening the inflation target. Ms Ekholm said that she shared Mr Öberg's view that there is uncertainty about the strength of the recovery, which also justifies the continuation of an expansionary monetary policy.

Ms Ekholm pointed out, however, that as previously she is not in favour of reducing the repo rate as the situation stands. As previously, there is no need to make monetary policy even more expansionary when the economy has entered a recovery phase. All the indications are that the recession has bottomed out. She believed that the estimates of mean squared gaps that Mr Svensson referred to when explaining his desire to further reduce the repo rate did not capture the consequences of reducing the repo rate to zero in the situation the economy is now in. It must be remembered that the parameterisation of the Ramses model, which forms the basis for these estimates, is largely based on historical links between different variables. Ms Ekholm said that we do not actually know very much about the form of these links given a monetary policy that differs entirely from how monetary policy decisions, historically speaking, have previously related to the economic situation. ´The analysis referred to by Mr Svensson does not therefore constitute a reliable basis for a decision. Ms Ekholm also said that developments relating to household credit and housing prices make it inappropriate to make monetary policy more expansionary in the current economic situation in Sweden.

Deputy Governor **Lars Nyberg** pointed out that the financial situation seems to have stabilised in Sweden too. The banks' possibilities to borrow internationally have further improved in pace with the recovery of the international credit markets. It is hard to see any shortage of lending capacity to support the approaching economic upturn. As far as the Swedish market is concerned, it has been possible to downwardly adjust the Riksbank's forecasts for the banks' loan losses as bankruptcies have not increased to the extent that was previously expected. Among the Baltic countries, which are still facing major problems and which account for half of the banks' loan losses, it appears that Estonia stands a good chance of meeting the demands for future membership of the EU. Latvia has managed to make budget cuts and has therefore met the demands of the EU and the IMF for the payment of the loans previously agreed on. Major risks remain, but it can nevertheless be said that uncertainty has declined. In a stress test in the Riksbank's latest Financial Stability Report it is noted that the banks have adequate capital to deal with a considerably more negative development of the situation than is actually expected. It is too soon to sound the all clear, but we should at least be able to breathe a little easier.

Since the summer, the picture of economic activity in Sweden has developed in a fragmented and somewhat unexpected way. Manufacturing activity continues to be weak, primarily due to a lack of demand for our export goods, although it now appears that the decline has bottomed out. In particular, companies that do business with Asia seem to have begun the upward climb to varying extents. In the service sector the course of development has been different. Here demand has not fallen in the same way as in the manufacturing industry and it appears that the downturn has been much less troublesome. Overall, development has been much better than the Riksbank believed in July, which has also led to the upward revision of the forecasts. In July the Riksbank expected the figure for GDP growth to be 0.5 per cent next year, now this figure has been revised upwards to 2.5 per cent.

The households are largely behind this in that they reacted in a way that was not expected during a year in which GDP fell by 4.5 per cent. Despite growing unemployment, household expectations of the future have improved steadily with regard to both the national economy and their own. It is expected that this year's Christmas shopping will reach record levels. The households are consuming more and they have increased their borrowing from banks and mortgage institutions. One effect of this has been increasing house prices in the midst of a severe recession. House prices were discussed extensively at the previous meeting and Mr Nyberg said that he had nothing new to say on this subject – apart from the fact that the latest figures indicate that prices are levelling out.

The fact that the households view their situation so positively is probably because they actually are in a better economic situation than before the crisis – as long as they have jobs. Taxes are lower and the interest rate burden for those who have loans has declined. However, the labour market has also developed much better than expected in July, so more households than expected have plenty of cash. The Riksbank's own forecast for unemployment next year has also been adjusted downwards by almost one percentage point compared with the forecast in July.

It thus appears that the households feel that they have emerged from the downturn while the manufacturing companies are still in it. When the Riksbank has aimed to stimulate demand with a record-low repo rate and other measures it has therefore succeeded in the case of the households – which is good, because what state would the economy be in otherwise? In the case of the companies, however, monetary policy has not yet had any real success in stimulating demand. The fact that the companies are not borrowing money to invest is, however, not because monetary policy is too tight but because demand from abroad has not yet returned. Many companies have excess capacity. It is also possible that the new demand will come from a different direction and be for different products than previously. The companies will wait to invest until this becomes clear.

This does not mean that the low interest rates mean nothing to the companies. Many companies have loans at short-term fixed rates and the low interest rates help them to meet interest and amortisation payments at a time when earnings are low. Without the low interest rates, more companies would go bankrupt.

In its monetary policy considerations the Riksbank has said that a low repo rate will be needed for some time to come. It is of course primarily the possibility of the companies to borrow in order to survive, and eventually to invest and grow, that the Riksbank has had in mind. The fact that the exceptionally low nominal interest rate has instead enticed the households to increase their borrowing is an effect of monetary policy that is manageable today but may eventually become a problem.

Mr Nyberg believed that the time is now ripe to begin discussing the current economic situation as a normal, although deep, downturn rather than as a financial meltdown. He said that he believed now, as he believed at previous meetings, that the rapid improvement of the international credit markets may have pushed the development of the real economy forwards in the same way as it was pushed backwards by the brutal rationing of credit that we saw after September last year. Developments in Asia may be a sign of this, but also the development of the labour market in Sweden and the behaviour of the Swedish households. Mr Nyberg therefore believed that in its forecasts the Riksbank tends to underestimate the strength of the upturn that can now be observed both in Sweden and abroad.

The Riksbank has now had the same repo rate path in its reports since July despite the fact that the situation has gradually improved at a faster rate than was expected at that time. This low repo rate will still be needed for some time, given the difficulty of assessing capacity utilisation in the manufacturing industry. Mr Nyberg's view was that the Riksbank should move away from the crisis repo rate of 0.25 per cent during the spring or summer of next year and begin a normalisation of the repo rate. On the other hand, Mr Nyberg believed that such a normalisation may take time. It is difficult to believe that the Riksbank would increase the repo rate as rapidly as it reduced it during the acute phase of the crisis last autumn, which is actually what is indicated by the forecast for the repo rate in the main scenario. Cutting the repo rate rapidly in a situation in which the financial markets have ceased to function is one thing. In a recovery that will take time, which the Riksbank has clearly stated is to be expected, new information will gradually be received which will justify gradual repo rate increases. Mr Nyberg found it difficult to imagine a course of development which would give the Riksbank cause to increase the repo rate as rapidly as it was reduced. In addition, the sensitivity of the households to repo rate increases has grown as such a large proportion of the loans have short-term fixed rates, which means that it is reasonable to assume that a given repo rate increase will have a greater impact on demand.

One reason why the repo rate path has not been adjusted in the Monetary Policy Update published in connection with today's meeting is the expectation that imported inflation will decrease and the value of the krona will increase. This would lead to falling inflation and reduce the need for repo rate increases. Mr Nyberg said that forecasts of the value of the krona should always be interpreted with caution as they have seldom turned out to be accurate. The Riksbank's models have also proved to be rather sensitive to changes in the exchange rate in the sense that an appreciation of the exchange rate has a rather substantial impact on the inflation forecast. There are therefore good reasons for questioning the inflation forecast and its effect on the repo rate path. Mr Nyberg's view was rather that increased activity in the economy may lead to bottlenecks and tendencies towards increased inflation more quickly than the Riksbank has previously had reason to believe. Mr Nyberg did not therefore see inflation as a problem with regard to a somewhat higher repo rate path initially.

Mr Nyberg summed up by saying that he agreed that the repo rate should be kept at 0.25 per cent today, but that he wished to enter a reservation against the proposed repo rate path. His forecast was that the Riksbank will have reason to increase the repo rate earlier, during the spring or summer of next year. The repo rate will then be increased somewhat more slowly than indicated in the proposed repo rate path.

Governor **Stefan Ingves** noted that various interest rate margins now appear to be within historical intervals and that the extra lending of approximately SEK 300 billion that will remain in place until the autumn of 2010 has had the intended effect. Given the current liquidity situation over the next few months and the results achieved, a further increase in lending is not now justified. There is no need to make monetary policy more expansionary in this respect.

The recovery in Sweden will take place from a low level and there is ample spare capacity. The labour market does not appear to be as weak as was forecast in October. Unemployment is nevertheless expected to rise over the coming year. The situation on the labour market means that wages will rise slowly in the period ahead, which will contribute to low inflationary pressures. All in all, inflation in the period ahead is expected to be somewhat lower than was forecast in October. This is mainly because it is estimated that inflation abroad will be slightly lower and that the krona will be slightly stronger, which will hold back import prices. Lower rents will also contribute to some extent.

Mr Ingves went on to highlight various risks. It is difficult to assess resource utilisation in connection with a financial crisis. Various indicators point towards low capacity utilisation in the business sector. According to the measurements of Statistics Sweden, capacity utilisation in the manufacturing industry is lower than during the crisis of the 1990s. Potential output growth depends on the development of productivity, real capital and human capital. All of these factors may have been hit by the crisis. More analysis of resource utilisation is needed in the period ahead as the conditions that govern production will not return to the same levels that prevailed before the crisis.

Lending to households has increased by 8 per cent while lending to companies is falling. Does this division of the credit market entail risks for the future? The stimulating effect of monetary policy is now helping to increase consumption, which is an important factor behind the recovery of the Swedish economy. At the same time, house prices have increased by 7 per cent since they hit bottom in the winter, but the rate of increase seems to have declined somewhat during the autumn. In a good scenario, with a gradually increasing repo rate from the autumn of 2010, the rate of price increases will slacken and the division of the credit market will gradually disappear. If this does not happen, a monetary policy dilemma will arise in which there will be a need to keep up the level of credit supply to the companies while, on the other hand, there will be a need to reduce the supply of credit for housing. It is important that a thorough analysis of the housing market is performed during the spring and the winter and that a clear conclusion is drawn concerning the extent to which further measures, in addition to monetary policy, are required to ensure stable development.

Mr Ingves summed up by saying that the new information received confirms the monetary policy assessment that was made in October. On the one hand the economic recovery has begun and there have been a number of upward revisions. On the other hand, inflation continues to be low, inflation expectations are anchored and the output gap is large and negative. These factors are pushing things in opposite directions, but there is a balance between them and there is therefore no reason to now change the repo rate path. To enable the economy to develop in a stable way and to meet the inflation target of 2 per cent the repo rate needs to remain unchanged at 0.25 per cent and it should remain at this level until the autumn of 2010. Given the exceptional circumstances of the recent past it is important to avoid a setback and a repo rate increase can therefore wait until the autumn of 2010.

When the economy recovers, the repo rate can be increased to normal levels and these changes will affect the mortgage rates included in the CPI. There will thus be large fluctuations in the CPI in the future. Underlying CPIF inflation is on the other hand stable, and will be close to 2 per cent at the end of the forecast period.

First Deputy Governor **Svante Öberg** noted that there is unity about the need to keep the repo rate low for a time and that it is not easy today to determine whether the increases should begin during the spring, summer or autumn. It is the case, as noted by Ms Wickman–Parak and Mr Nyberg, that the figure for GDP has been revised upwards and the figure for unemployment revised downwards between the forecasts in July and December.

GDP growth has been revised upwards by a total of 2.5 percentage points for the period 2009 to 2011. At the same time, however, the figure for CPIF inflation has been revised downwards by a total of 1.2 percentage points for the same period. But most of the revisions were made between July and October. This was taken into account already in October. There is therefore no reason to bring the repo rate increases forward. Mr Öberg added that his assessment was still that the appropriate time to begin increasing the repo rate is next autumn.

There is, however, reason to discuss the pace at which the increases should be made as the picture of future developments becomes clearer. Mr Öberg said that he could see a need to increase the repo rate more slowly than the Riksbank now predicts, especially if GDP growth and inflation are lower than expected.

There is also reason to discuss commodity prices. There is a risk that these prices will increase more than the Riksbank now estimates. This would not only lead to somewhat higher inflation in the USA and Europe, but also to slightly lower growth. It is therefore not possible to draw any clear-cut conclusions about what such a development would mean to monetary policy. The development and consequences of commodity prices is a question that there will be reason to return to at future meetings.

The question of a zero interest rate has been discussed on several previous occasions. Mr Öberg said that his main reason for not reducing the repo rate further is that it would involve entering unchartered waters - we do not know what would happen if the repo rate were to be set at zero – and it is uncertain that this would have anything other than marginal positive effects. It is good that there are models that we can use to simulate various alternative scenarios. But all models are simplifications of reality. For example, Ramses assumes that repo rate cuts have the same effect irrespective from what level they are made. Mr Öberg said that he believes that the effects of a cut from the current low level would be less than if we were at a more normal repo rate level. There are also other simplifications, for example that employment even in the short term is affected more or less as much as GDP, which is contrary to empirical experience.

Deputy Governor **Lars E. O. Svensson** wished to comment on what Ms Ekholm said about her lack of trust in the graphs he presented. He wished to emphasise that they are mainly based on the fundamental insight that a lower repo rate path leads to higher inflation and higher resource utilisation. The quantitative estimates that he mentioned are, as he previously emphasised, not the final word. They do, on the other hand, represent the latest and best word available as yet. There is of course a degree of uncertainty regarding the effect of the lower repo rate path on employment, but it is very unlikely that it would not fall within the wide range of 10 000 to 25 000 jobs saved. The claim that these estimates may be rather good and applicable in this case is also supported by the fact that the financial markets have normalised and the situation, as Mr Nyberg said, is more and more reminiscent of a severe downturn than of a major financial and economic crisis. This indicates that historical economic relationships should now apply to a greater extent than previously during the crisis.

Mr Svensson said that if Ms Ekholm has a more reliable forecast for inflation and the real economy with a lower repo path, or a better measure of the stabilisation of inflation and resource utilisation than the mean squared gaps, then it would of course be interesting to see them. If one claims that a lower repo rate path would lead to a worse rather than a better stabilisation of inflation and resource utilisation, one should be able to present an analysis that supports this. With such an analysis one might perhaps even prefer a higher repo rate path than the one in the main scenario. Mr Svensson therefore wished once again to emphasise that it is important, in order for the Riksbank to be able to very clearly justify the repo rate decisions and enable a fair evaluation of monetary policy, to properly discuss alternative repo rate paths and assess what degree of target achievement they will result in. He therefore wished to advocate the inclusion of an analysis of alternative repo rate paths in the Monetary Policy Updates and not only in the Monetary Policy Reports.

Governor **Stefan Ingves** then summarised the monetary policy discussion. The recovery from the severe recession is continuing. The financial markets are improving all the time and the measures taken by central banks and public authorities are having an effect. The world economy is continuing to improve and this benefits economic developments in Sweden. Households and companies have become more optimistic regarding future developments and consumption is increasing. However, the picture is not clear-cut. For example, industrial production is still weak.

The recovery is from a low level and there will be ample spare capacity over the coming years. The labour market does not appear to be as weak as was forecast in October. But unemployment is nevertheless expected to rise over the coming year. The labour market situation will mean that wages rise slowly. This will contribute to low inflationary pressure. At the same time, inflation is expected to be lower than was forecast in October. This is mainly because inflation abroad will be lower, and the krona will be slightly stronger, which will hold back import prices.

The repo rate needs to be low over a long period of time to attain the inflation target of 2 per cent and to support the economic recovery. The repo rate should therefore remain unchanged at 0.25 per cent and the repo rate is expected to remain at this level until the autumn of 2010. The repo rate will then be increased to more normal levels. The forecast for the repo rate is the same as in October. Changes in the repo rate affect mortgage rates, which are included in the consumer price index (CPI). There will thus be large fluctuations in the CPI in the future. The CPIF underlying inflation rate (the CPI with a fixed mortgage rate) is on the other hand more stable, and will be close to 2 per cent at the end of the forecast period.

The future direction for monetary policy will depend, as always, on how economic developments abroad and in Sweden will affect the prospects for inflation and economic activity in Sweden.

§ 4. Monetary policy decision

The Chairman observed that there was a proposal to hold the repo rate unchanged at 0.25 per cent and a proposal to cut the repo rate by 0.25 percentage points.

The Executive Board decided after voting

- to adopt the Monetary Policy Update according to the proposal, Annex A to the minutes.

- to publish the Monetary Policy Update on Wednesday 16 December at 09.30 a.m.,
- to hold the repo rate unchanged at 0.25 per cent and that this decision would apply from and including 23 December 2009,
- to hold the lending rate unchanged at 0.75 per cent, and the deposit rate unchanged at -0.25 per cent, with effect from and including 23 December 2009,
- to announce the decision at 9.30 a.m. on Wednesday 16.December 2009 with the motivation and wording contained in Press Release no. 103 2009 (Annex B to the minutes), and
- to publish the minutes of today's meeting at 9.30 a.m. on Monday, 4 January 2010.

Deputy Governor Lars E.O. Svensson entered a reservation against the decision and advocated cutting the repo rate to 0 per cent and a repo rate path 0.25 per cent below that in the main scenario until the end of the third quarter of 2010. Mr Svensson asserted that such a repo rate path entails a better-balanced monetary policy, with lower unemployment, higher resource utilisation and a CPIF inflation rate closer to the target, without causing any problems to the functioning of the financial markets or to financial stability. Deputy Governors Lars Nyberg and Barbro Wickman-Parak supported the decision to hold the repo rate unchanged at 0.25 per cent, but entered reservations against the repo rate path in the Monetary Policy Update. Their stance was motivated with reference to a slightly more positive view of growth prospects and that economic activity is now starting to become normalised. They considered that it would be necessary to raise the interest rate sooner than indicated by the proposed repo rate path, but that the path would then not need to be so steep during the remaining forecast period.

This paragraph was confirmed immediately.

Minutes by

Ann-Christine Högberg

Checked by:

Karolina Ekholm	Stefan Ingves	Lars Nyberg
Lars E.O. Svensson	Barbro Wickman-Parak	Svante Öberg