Monetary policy minutes

October 2017

Summary

At the Monetary Policy Meeting on 25 October 2017, the Executive Board of the Riksbank decided to hold the repo rate unchanged at −0.50 per cent. The first rate increase is expected to be made in the middle of 2018, which is the same assessment as made at the meeting in September. The purchases of government bonds will continue during the second half of 2017, as decided by the Executive Board in April. As the present asset purchase programme will run for the remainder of the year, it will provide an opportunity to await further information that could affect a decision in December to possibly extend the purchases. The Executive Board has also decided to extend the mandate that facilitates a quick intervention on the foreign exchange market.

The Executive Board agreed on the picture of economic development and the inflation outlook described in the draft Monetary Policy Report. It was noted that developments since September have been in line with the Riksbank's earlier assessment and that there have not been any decisive changes in the forecasts.

Global inflationary pressures are subdued and the normalisation of monetary policy abroad is expected to take time. In Sweden, economic activity is strong. CPIF inflation has risen and, like inflation expectations, is close to 2 per cent. However, part of the recent upturn in inflation is explained by temporary factors and inflation is therefore expected to fall back somewhat in the coming months.

All of the members noted that a continued expansionary monetary policy was needed for inflation to remain close to 2 per cent going forward. The Executive Board agreed to hold the repo rate unchanged at −0.50 per cent and no member entered a reservation against the forecast for the repo-rate path. Purchases of government bonds will continue for the remainder of the year in accordance with the previous decision. There were slight differences of opinion among the Board members as to whether the purchases of government bonds should be extended beyond this. However, they agreed that there is time to await further information that may be important for a decision on a possible extension at the December meeting. Several members emphasised the importance of the exchange rate for the economic outlook and inflation prospects, and that, in this context, it is important to take into account that the Riksbank's monetary policy does not deviate too far from that in other countries.

Several members discussed the developments on the Swedish housing market. It is a welcome development that housing investment has increased and price rises are slowing down. However, there are risks associated with this development. If new construction is based on incorrect assessments of the type of housing in demand and on overly optimistic forecasts of continued price rises, there could be problems further ahead. As housing prices have risen, household debt has increased and the financial system has become more vulnerable. The Board members emphasised, as on many previous occasions, the need for a combination of measures in several different policy areas to attain long-term sustainable development.

A majority of members of the Executive Board decided to extend the mandate facilitating rapid intervention on the foreign exchange market, against the backdrop of the significance of the krona for inflation. Two members entered reservations, with slightly different motivations.

MINUTES OF MONETARY POLICY MEETING

Executive Board, No.5

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DATE: 25/10/2017

TIME: 09.00

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

Susanne Eberstein, Chairperson of the General Council
Michael Lundholm, Vice Chairperson of the General Council

Meredith Beechey Österholm
Claes Berg
Charlotta Edler
Bo Enegren
Lena Eriksson
Mattias Erlandsson
Kerstin Hallsten
Jens Iversen
Ola Melander
Pernilla Meyersson
Ann-Leena Mikiver
Christoffer Nordenlöw (§ 1)
Bengt Petersson
Maria Sjödin
Ulf Söderström
Anders Vredin
Fredrik Wallin (§ 1)

It was noted that Bo Enegren and Bengt Petersson 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 September, government bond yields have risen somewhat, particularly in the United States and United Kingdom. In the United States, the incoming macro data have in general been better than expected, at the same time as the process of approving the proposed tax reform has made some progress. This has contributed to market expectations of policy rate increases in the United States rising. In the United Kingdom, the central bank has been clear that a policy rate increase is imminent, which has surprised market participants and led to an increase in expectations of future rate hikes. Interest rates in the euro area have fluctuated less than in the United States and United Kingdom. It is thought that interest rate increases from the European Central Bank (ECB) are still fairly far off in the future, but a tapering of the net asset purchases is expected after the turn of the year.

Prior to today's monetary policy decision, it is assumed that the repo rate will be held unchanged. Market expectations of the timing of a first repo-rate increase by the Riksbank have been postponed somewhat, from April to the middle/second half of 2018. Market participants are still assuming that the Riksbank will take into account the actions of the ECB in its monetary policy. Moreover, the probability of the Riksbank extending its asset purchase programme has increased. The Swedish krona has weakened in trade-weighted terms since the monetary policy meeting in September. This is partly connected with a general strengthening of the US dollar against most currencies during this period. A weaker inflation outcome than expected in September and some concern over recent developments on the Swedish housing market have probably also contributed. Equity prices have risen both in Sweden and abroad, supported by strong economic signals and despite many remaining political risks such as the North Korean conflict and the uncertainty in Europe surrounding Brexit.

Mattias Erlandsson, Acting Deputy Head of the Monetary Policy Department, began by presenting the draft Monetary Policy Report which, in the assessment of the Monetary Policy Department, would gain the support of the majority of the Executive Board members. The monetary policy drafting process has included discussions with the Executive Board regarding the forecasts and the monetary policy assumptions at meetings on 9, 10 and 17 October. The draft Monetary Policy Report was discussed and tabled at a meeting with the Executive Board on 19 October.

Mr Erlandsson then summarised the new information received since the September Monetary Policy Report. GDP growth in Sweden was somewhat lower in the second quarter, according to revised data, than in the preliminary outcome. At the same time, the levels for 2015 and 2016 have been revised up so that GDP in the second quarter was as expected. The forecast in the draft Monetary Policy Report for the second half of the current year has been revised up because of strong indicators for the Swedish economy, including the labour market. Although unemployment was somewhat higher than expected in the third quarter than forecast in the September Monetary Policy Report, at the same time employment and the labour force increased more than expected, so overall development on the labour market is still strong. The forecast for unemployment in the draft Monetary Policy Report has been revised down somewhat for the years 2019-2020, partly as a result of measures proposed in the Government's Budget Bill. Two new outcomes have been published since the September Monetary Policy Report, for August and September. Both outcomes were 2.3 per cent. The outcome for September is somewhat lower than was expected in the assessment in September and the forecast for the coming months has been revised down. In the forecast, inflation is expected to fall in the coming months, when prices of foreign travel and energy increase more slowly. Expectations of CPI inflation were close to 2 per cent at one, two and five years ahead, according to the Prospera survey in October. For the first time, the inflation expectations for the CPIF were also measured. They were also close to 2 per cent at all time horizons. The krona has been somewhat weaker than was expected in the September Monetary Policy Report, but is expected to strengthen going forward and to be in line with the September forecast.

Mr Erlandsson noted that the recovery in international economic activity is continuing and the forecast remains largely unchanged compared with that in the September Monetary Policy Report, although there has been some upward revision to GDP forecasts for the euro area. Inflation is subdued and there are expectations of continued low interest rates. Market expectations of policy rates in the United States and United Kingdom have shifted upwards, however, while market agents are expecting that the ECB's net purchases of assets will continue for most of 2018, albeit on a smaller scale. There is still economic and political uncertainty abroad and this has not changed markedly since September.

Mr Erlandsson noted further that economic activity is still strong in Sweden, too, and that resource utilisation is higher than normal. The forecast for the Swedish economy also remains largely unchanged in relation to the September report. GDP growth is expected to be high this year and next year and then to slow down as a result of slower growth in the working age population, somewhat lower growth abroad and falling housing investment. Unemployment is expected to fall somewhat further, but the structural problems on the labour market need to be remedied to attain a more significant downturn in unemployment. The inflation forecast for the coming years remains largely unchanged. The forecast in the draft Monetary Policy Report assumes that economic activity will remain strong and that the krona will not strengthen too quickly.

Mr Erlandsson emphasised that the forecasts in the draft Monetary Policy Report are based on the assumption that monetary policy will remain expansionary and that the forecasts will be supported by a majority of the Executive Board at the monetary policy meeting. The forecast for the repo rate is that it will be held unchanged at –0.50 per cent and that an initial rate increase is not expected until the middle of 2018, after which the repo rate will be slowly raised. The purchases of government bonds will continue in accordance with the decision in April and the mandate enabling a rapid intervention on the foreign exchange market is expected to be extended until July 2018.

Mr Erlandsson then identified four important questions that have been the subject of particular discussion in the monetary policy drafting process in October. The first was whether activity in the Swedish economy was now so high that overheating problems could be expected further ahead. An article in the draft Monetary Policy Report draws the conclusion that while economic activity is stronger than normal, there are no major imbalances in the economy in general and there are still few signs of wages and prices rising rapidly. However, there is still a need to follow developments closely and be aware of possible signs of overheating, both in the economy in general and in individual sectors. Developments on the housing market are particularly relevant, partly because housing construction has increased very rapidly in recent years. The second question is the interpretation of the inflation outcomes in recent months and to what extent these are due to temporary or more underlying factors, and what the interpretations imply for developments in the short term. A third theme has been how monetary policy abroad affects the Swedish economy, with a particular focus on possible effects on the krona exchange rate. The fourth theme is developments on the labour market. A number of aspects have been highlighted during the drafting process, including why labour supply is increasing so rapidly, how matching between unemployed and job vacancies is working and problems regarding statistics.

§2. The economic situation and monetary policy

Deputy Governor **Martin Flodén** began by saying that he supports the proposal to leave the repo rate unchanged, but not the proposal to extend the mandate that facilitates rapid intervention on the foreign exchange market. He otherwise supports the draft Monetary Policy Report and the forecasts contained within it, including the forecast for an appropriate repo rate in the period ahead.

Mr Flodén mentioned that economic developments abroad have been in line with the forecast in the Monetary Policy Report in September. This applies both to the development of economic activity and inflation. Households and companies are optimistic and economic activity continues to strengthen in the euro area while international inflationary pressures are subdued. A development worth mentioning is that the market's pricing of future policy rates abroad has shifted upwards slightly. The converse development – that pricing had shifted downwards – was a factor that indicated a continued need for very expansionary monetary policy in Sweden at the monetary policy meeting in September.

Also in Sweden, economic developments have been in line with the forecast in the Monetary Policy Report in September, although both economic activity and inflation data have developed marginally weaker than expected. The most significant development is that in September inflation came in lower than forecast after having been surprisingly high in the five previous months. These outcomes do not alter the picture of continued strong economic activity and underlying inflation that is close to the inflation target and significantly higher than a few years ago.

There has been much discussion about developments on the Swedish housing market, Mr Flodén continued. The focus of the discussion has shifted from rapid debt and price rises and a low level of construction to prices that are not rising as quickly, and perhaps even falling, and the risks associated with the high level of housing construction. The fact that housing price increases have slowed from a two-digit percentage annual rate is, of course, welcome rather than problematic. And the increase in housing investment has been necessary after two decades of a remarkably low level of construction despite rapid population growth, good economic development and rapidly rising housing prices.

However, Mr Flodén also underlined the risks associated with this development. The fact that price rises are slowing and it is taking longer to sell housing is not strange if a large number of newly built homes come out onto the market in a short space of time. But the rapidly rising housing prices and major change in the housing sector’s activity level in recent years indicate that the housing market is not functioning well. The question is how well equipped participants on the housing market are to manage a development with a larger supply of housing and prices that are no longer rising quickly, Mr Flodén said.

In the forecast in the draft Monetary Policy Report, housing price are expected to continue upwards, albeit at a slower pace, and housing construction is set to slow slightly. He considered this to be a reasonable forecast, but where a substantial slowdown in construction is a clear downside risk. A more substantial slowdown in construction would weaken economic activity and probably lead to lower inflationary pressures and thereby also to the need for an expansionary monetary policy for even longer. At the same time, such a slowdown in construction would indicate that the structural problems on the housing market are even greater than we realise. This would suggest that the current level of construction is presupposing rapid price increases in combination with modest amortisation requirements placed on indebted households in an extreme low-interest-rate environment. Despite the need for more housing, maintaining such an order cannot be in the interests of society.

Mr Flodén then returned to his monetary policy considerations. The assessment of the economic outlook and inflation prospects, in his opinion, is roughly unchanged compared with the monetary policy meeting in September. He therefore advocates a monetary policy according to the same plan communicated at that time. This means that the repo rate is left unchanged at – 0.50 per cent and that the Executive Board expects it to be appropriate to keep the rate at that level until the middle of next year before slow increases are initiated.

Mr Flodén said that, at the monetary policy meeting in September, he had drawn attention to the unusually large uncertainty surrounding the assessment of the repo-rate path. According to him, one reason was that the relatively high inflation might be more persistent than the assessment in the Monetary Policy Report at that time, something that would indicate that the repo rate might need to be raised earlier than forecast in September. Another reason was that the market was expecting more expansionary monetary policy abroad, something which would make early rate rises in Sweden more difficult. Recently, however, inflation has come in slightly lower than forecast in the September Monetary Policy Report, which reinforces the assessment that low interest rates are still needed to keep inflation at around the target level, while market pricing of international policy rates has shifted upwards slightly, which will facilitate rate rises in Sweden. Mr Flodén therefore thinks that the uncertainty over the appropriate repo rate going forward has decreased slightly. Despite this, of course, the uncertainty surrounding the repo-rate forecast is, as always, considerable.

Mr Flodén then touched on the discussion about the programme for buying Swedish government bonds. The programme will cease at the end of the year, and in the draft Monetary Policy Report it is stated that any decision to extend the programme will be taken at the monetary policy meeting in December. He sees no reason to make a decision on this today but he wishes nevertheless to point out that he does not expect to advocate an extension to the programme at the meeting in December.

When the latest decision on bond purchases was taken at the monetary policy meeting in April, Mr Flodén wanted purchases to be discontinued. The reasons for continued bond purchases have not strengthened since then, in his opinion. Resource utilisation is still high. Interest rates are low, access to credit is good and financial conditions are also good in general. The krona is not appreciating in a way that hampers a continued uptick in inflation. Inflation and inflation expectations have risen, indicating stronger confidence in the inflation target. The Government has announced an expansionary fiscal policy prior to next year. In addition, it is Mr Flodén's assessment that continued asset purchases no longer make Swedish monetary policy noticeably more expansionary. The largest effect of the asset purchases has probably occurred in the form of certain short-term market rates having been pressed down towards the floor at –0.90 per cent set by the Swedish National Debt Office's repo facility. This effect will probably persist for some time to come even if bond purchases end after the turn of the year.

In this context, it is sometimes mentioned that the purchases must be adapted to the ECB's purchases. Mr Flodén's assessment is that such an adaptation of the buying programme is not particularly important in the current situation. This is partly due to the fact that the Swedish economy is in a phase with stronger resource utilisation and higher inflation than in the euro area, but mainly because Mr Flodén deems that continued asset purchases are no longer an important element of Swedish monetary policy. He also noted that it has been no problem to reduce asset purchases from a rate of about SEK 60 billion per half-year in 2015 and 2016 to SEK 15 billion during the autumn of this year. All this during a period in which the ECB has kept its purchasing rate more or less unchanged. Calculated in annualised terms in relation to GDP, the Riksbank's purchases now correspond to 0.6 per cent compared to 6 per cent in the euro area. Mr Flodén pointed out that this reasoning applies just to asset purchases. His assessment is that the development of the Swedish repo rate in relation to the ECB's policy rate still has considerable bearing on how expansionary Swedish monetary policy will be.

Mr Flodén concluded his comments by once again stating that he did not support the proposal to extend the mandate that facilitates rapid intervention on the foreign exchange market. His reasons are the same as when the previous decisions on this mandate were taken in January, February and July 2016 and in February 2017. He pointed out that, among the factors influencing his opposition to the decision are, first of all, that he considers the use of tools that only have an impact via the exchange rate to be dubious. This is especially true as both resource utilisation and inflation are higher than in Sweden's neighbouring countries, as the krona, according to him, is not overvalued and as 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 the negative effects on inflation abroad. And secondly, Mr Flodén doubts the effectiveness of currency interventions. It may 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 the forecast in the draft Monetary Policy Report that the krona will strengthen slightly over the coming years. Mr Flodén did not rule out a scenario where foreign exchange interventions are justified, but he considers the Swedish economy to be far from such a scenario at this present time.

Deputy Governor **Cecilia Skingsley** began by saying that she supports both the assumptions and forecasts in the draft Monetary Policy Report and the draft monetary policy decision. According to Ms Skingsley, the best balanced monetary policy action at this present time is therefore not to change it, i.e. to keep both the repo rate and the forecast for the future repo rate, along with the plan for bond purchases, unchanged.

In addition, she would like to comment on three factors that are important for monetary policy: the risks in the global economy, Sweden's dependence on monetary policy abroad and finally the risks of imbalances in the Swedish economy.

Ms Skingsley noted that the global economic recovery is continuing in line with the Riksbank's previous assessments and that it is a crucial factor for the strong developments in Sweden. She also pointed out that, while international economic activity is favourable, there are a number of structural problems abroad. For example, indebtedness in both the public and the private sector is on a very high level in many countries and long-term unemployment has risen after the global financial crisis and debt crisis in the euro area. To this can be added high political uncertainty which is hampering the willingness to invest and long-term output capacity. Ms Skingsley noted that electoral support for greater economic nationalism is growing in many countries. Support has also increased for parties and groups who proclaim to speak for the many people who think that cross-border economic cooperation is to their detriment.

According to Ms Skingsley, policies that lead to higher national barriers to the flow of goods, services, people and capital risk damaging growth in the short term, as a result of, for example, shocks on the financial markets or reduced optimism among companies and households. Even in the long term, such introverted policies are a threat in the form of weaker productivity and poor conditions for growth. Bearing these risk factors in mind, along with low global inflationary pressures despite good growth, monetary policy abroad is generally providing strong support to economic activity. Central banks that have begun tightening are doing so gradually and are, to a large extent, adapting policy to incoming data.

Ms Skingsley further asserted that it is important for the Riksbank, which now has to manage an achieved inflation rate close to the target of 2 per cent, to safeguard fulfilment of the target and to ensure that inflation expectations are anchored more permanently around it. It has taken longer to attain this and required greater stimulus than was forecast. Ms Skingsley noted that forecasting errors must also be expected in the future and that she will be very much guided by incoming data to assess what the most well-balanced monetary policy is going forward.

She also pointed out that monetary policy abroad, and especially in the euro area, is an important factor in this context. As at previous monetary policy meetings, the Executive Board has made an assumption at today's meeting about the ECB's monetary policy in the period ahead. An expansionary monetary policy in the euro area will contribute to higher growth there, which is also beneficial for Swedish growth. However, the monetary policy challenge facing the Executive Board of the Riksbank is that the difference between the ECB's and the Riksbank's monetary policy, in terms of growing yield differentials, must not be so large as to make the krona exchange rate a problem for Sweden's economic and inflation prospects. Ms Skingsley reminded the meeting that she had previously said that an inflation rate close to target and well-anchored inflation expectations increase the Riksbank's latitude. This means that a decision from the ECB on a more expansionary monetary policy need not automatically be followed by a more expansionary monetary policy from the Riksbank. She still has this point of view. Should, however, the prospects for inflation and economic activity in Sweden become a clear threat to the Riksbank's scope for achieving the inflation target, regardless of what the ECB does, she does not rule out the possibility of supporting further monetary policy stimulus. She therefore also supported the decision made at the meeting to extend the mandate for foreign exchange interventions. According to Ms Skingsley, the mandate enables rapid reaction should the exchange rate develop too unfavourably.

Ms Skingsley also wished to stress that, as regards deviations from the Riksbank's inflation forecasts, she still sees inflation outcomes that are lower than forecast as potentially a greater problem than the opposite, bearing in mind the long period of excessively low inflation and drifting inflation expectations.

An important forecasting issue that Ms Skingsley touched on at the monetary policy meeting in September, and that is discussed in an article in the draft Monetary Policy Report, is whether the Swedish economy is starting to overheat. She finds it difficult to see signs of prices or wages developing in such a way as to give cause for concern regarding overheating of the Swedish economy. Bearing in mind the long period with below-target inflation, resource utilisation also needs to be kept high so that price and wage development is line with the inflation target. That said, it is perfectly possible, according to Ms Skingsley, that there are parts of the economy where prices and wages are increasing at a rapid pace. So far, she considers this to be relative price changes, where price formation is facilitating general resource allocation by signalling within which sectors demand is high and where more resources need to be steered, for example in the form of labour and investment.

The housing sector, however, still constitutes a structural risk to the Swedish economy, according to Ms Skingsley. Rapid housing price increases have been a problem for many years, regardless of the level of interest rates in Sweden. Bearing in mind that housing construction has previously not risen as fast as demand, and that the population is growing, the increase in new housing construction is welcome, but the high rate of increase also brings with it elevated economic risks that must be carefully monitored. The Riksbank's forecast is that housing price increases will subside in the period ahead, partly as a result of greater supply. Against the backdrop of recent information about increased nervousness on the housing market, Ms Skingsley wished to clarify her view on the allocation of responsibilities in these issues.

She noted that the Riksbank had no target for housing prices, but the responsibility for financial stability is shared with Finansinspektionen, the Swedish National Debt Office and the Ministry of Finance. As regards managing the vulnerabilities in the form of growing debt due to rising housing prices, Ms Skingsley wished to describe it as four lines of defence:

The first line of defence is, in her opinion, the decisions made by borrowers and lenders themselves. Each party is responsible for the risks they chose to take. The second line of defence is Finansinspektionen's microprudential policy, summarised very briefly here as capital and liquidity requirements and the credit assessment process. The third line of defence is Finansinspektionen's macroprudential policy, that is to safeguard system stability and increase the resilience of, for example, lenders via special capital add-ons and borrowers in the form of tighter amortisation requirements. The fourth line of defence is the other rules that affect the supply and demand of housing, including taxes and construction rules.

Ms Skingsley also sees that monetary policy, under certain circumstances, can be used to combat the effects of major household debt, but that an interest rate hike in the current situation in order to slow down the build-up of debt would lead to lower GDP growth and higher unemployment and hence impair achievement of monetary policy targets. She thinks that there are better tools than monetary policy and she wishes therefore to emphasise the wording in the Monetary Policy Report about the necessity for a holistic approach in housing and tax policies to create a better balance between the supply and demand of housing. With continued low interest rates for a long time, it is important for Finansinspektionen's proposal for tighter amortisation requirements for those taking large loans in relation to their incomes to be implemented. Further measures aimed at increasing households' resilience also need to be carried out.

Deputy Governor **Per Jansson** began by observing that the inflation picture continues to be bright. Since the September monetary policy meeting, two new outcomes for inflation and inflation expectations respectively have been published. The inflation outcomes, which were for August and September, reported CPIF inflation as stable around 2.3 per cent. The new outcomes for inflation expectations, which concerned Prospera's quarterly survey in September and its monthly survey in October, now show that all respondents have expectations of inflation two and five years ahead that are just over the inflation target. Expectations one year ahead have at the same time continued to rise and are at or above 1.9 per cent for all groups. Mr Jansson regards the fact that inflation expectations in the slightly longer run somewhat exceed the inflation target as welcome, as this reduces the risk that expectations will once again fall below the target if new negative inflation surprises arise.

He noted that, compared with the Monetary Policy Report in September, it is now proposed to make only minor changes to the inflation forecast, over and above short-term forecast error adjustments. In line with the previous forecast, CPIF inflation is expected to fall back somewhat in the near future before stabilising around 2 per cent over the rest of the forecast period. Mr Jansson supported this assessment of inflation developments and other forecasts made in the draft Monetary Policy Report. He also supported the assumption for monetary policy upon which these forecasts are based and said that it is important in this context to emphasise the close connection that here prevails between monetary policy and inflation. The development of inflation that has been forecast presupposes a continued markedly expansionary monetary policy, which, among other things, is associated with a slow and orderly appreciation of the krona exchange rate in the years ahead.

The fact that the assessment in the main scenario is more or less unchanged does not of course exclude the possibility that inflation could be both higher and lower than expected, which is also discussed in the draft report. Outside of the Riksbank, risks of overheating are now being discussed at some length and it seems reasonable to assume that the focus there is mainly on inflation sooner or later surprising on the upside, in a situation where it is also above the inflation target. Here, Mr Jansson wished to take up some aspects of such a possible inflation development, and in so doing contribute to shedding light on which monetary policy decisions he would urge and support.

During the long period with an inflation rate far below the target, inflation outcomes that have exceeded the forecasts have been a welcome element. The background to this is of course that inflation has then approached the target more quickly than expected. On some occasions during the current year, however, under-predictions of inflation have instead led to inflation overshooting the target and target attainment being somewhat poorer than thought. The question that then arises is whether monetary policy should not be adjusted in a less expansionary direction, for the purpose of counteracting the unexpectedly high inflation rate. The reason why this has not happened so far is largely because the deviations have been assessed to be temporary. Admittedly, the Riksbank's forecasts some years ahead in time have for a while now been characterised by flattening out at just over 2 per cent. But the target deviation has not been particularly large so far. It is nevertheless important to relate to the new situation with an inflation rate that can possibly overshoot the target and to try to explain how large a deviation can be accepted without it being necessary to adapt monetary policy, Mr Jansson reasoned.

He went on to say that one aspect of this is about the perspective one has on target deviations. Prior to the financial crisis, there was a debate in Sweden on the inflation target, where some people argued that an average inflation rate of around 1.5 per cent was a major failure and very poor target attainment. The Riksbank often defended itself against this kind of criticism and pointed out, for instance, that a deviation of this size was fairly small, remembering how much inflation had varied during the years prior to the inflation target. The Riksbank also emphasised that it was difficult to steer inflation towards exactly 2 per cent, even though this was always the intention. From this perspective, an inflation rate that for some time happens to end up a few tenths of a percentage point above the target should not be judged to be a major failure that requires immediate action either. The recently introduced variation band hopefully helps to clarify this.

Another aspect, he said, is linked to the low inflation and the falling confidence in the inflation target in recent years. If it is the case that expectation formation during this period has been influenced so that some still suspect that it is more probable that inflation will undershoot rather than overshoot the target, then an inflation rate that is allowed to be a little higher than 2 per cent for a period could have the desirable effect of making expectation formation more symmetrical again. It is then not a question of the Riksbank having switched to a price level target, but rather that there is awareness that economic agents to a large degree base their expectations on historical experiences.

Having said this, it is of course important to emphasise that this is not about letting inflation increase without boundaries, Mr Jansson added. The desired effect, as already mentioned, is to make expectation formation more symmetrical, not to have inflation expectations that systematically lie clearly above the target. If this were the case, it would of course be important for monetary policy to react.

However, Mr Jansson stated that he currently assesses the risk of inflation overshooting 2 per cent by a long way as very limited. Service prices in Sweden are already rising much faster than their historical average in recent years. To attain an inflation rate of 3-3.5 per cent with the current rate of increase in goods and food prices, service price inflation would need approximately to double from the current level.[1] He pointed out that such a development appears very unlikely, particularly as wage growth in Sweden is moderate and inflation abroad is also low.

The fact that the risk of monetary policy rapidly and dramatically needing to be made less expansionary is very slight does not of course mean that the current policy will never need to be normalised. The circumstances that might make it necessary to seriously begin discussing a phase-out of the very expansionary monetary policy had already been touched on by Mr Jansson at the monetary policy meetings in July and September. In his view, it is a question of three, not mutually independent conditions that need to be met.

The first, and most important, condition is for more underlying inflation to have remained close to 2 per cent for several months. The second condition is that the krona exchange rate must not appreciate too quickly and too much. And the third condition is for other central banks, in particular the ECB but also the US Federal Reserve, to have started phasing out their expansionary policies to a greater extent, or at least to be more concrete as regards how they intend to do so.

With respect to the development of inflation and the exchange rate, Mr Jansson considered that there has not been much to complain about since the monetary policy meeting in September. It is perhaps somewhat worrying that the more underlying rate of inflation measured as the CPIF excluding energy prices was a good 0.3 percentage points lower than forecast in the September Monetary Policy Report. But the outcome nevertheless amounted to 1.9 per cent, which is still close to 2 per cent. The krona exchange rate has at the same time been slightly weaker than

[1] The calculation assumes that energy prices will develop in line with the forecast in the draft Monetary Policy Report.

expected. Against the euro, the weakening amounts to around 1.5 per cent and against the US dollar to around 3 per cent.[2] He said that this is of course a welcome development.

However, the decisive question, in Mr Jansson's opinion, is how well this development will stand going forward. One major challenge is that inflation is predicted to fall back at the end of 2017 and beginning of 2018. This is linked to different temporary effects, energy prices, and the exchange rate to a lesser extent helping to keep up CPIF inflation. When so many factors are pulling inflation in the same direction, there is of course a risk that the overall effect is underestimated, which could lead to the rate of inflation declining more than expected.

Successfully positioning the Riksbank's monetary policy normalisation in relation to the normalisation abroad may perhaps be an even greater challenge. On this point, there are clearly different views, both within and outside of the Riksbank. Mr Jansson's own view, which he has already expressed on a number of occasions, is that a small open economy with extensive trade with other countries, and especially the rest of Europe, takes on substantial risks if it invests in beginning to normalise monetary policy at an early stage. The inflation forecast assumes, as he has mentioned earlier, that monetary policy is conducted in such a way that the krona exchange rate in the coming years will strengthen slowly and in an orderly manner. Just as in July and September, he is very doubtful whether this can be achieved if the Riksbank stops its asset purchases completely at the end of the year, while the ECB continues to make further purchases during 2018.

The plan now is to decide on a possible extension of the asset purchases in December. According to Mr Jansson, there are some risks linked to not taking a decision on this now. If the ECB's decision turns out to be softer than expected, the krona exchange rate could in a bad scenario be affected quite substantially, and monetary policy in Sweden would then lag behind. But the strategy of waiting until December has the advantage that the Riksbank will then know more, both about how other central banks are acting and about how inflation in Sweden is developing. Mr Jansson stated that for his part he would probably have preferred to take a stance now, but that he had understanding for those who think there are greater advantages in waiting. If the monetary policy decision in December were to make monetary policy more expansionary by continuing to buy assets in 2018, Mr Jansson considers that it will also be natural to somewhat postpone a first increase in the repo rate. This would of course have an additional expansionary effect, which would need to be taken into account when designing future purchases.

First Deputy Governor **Kerstin af Jochnick** began by saying that she supports the assessments in the draft Monetary Policy Report and that she also backs the proposal to keep the repo rate at −0.5 per cent and the repo rate path unchanged. She also backed the proposal to extend the mandate for foreign exchange interventions.

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[2] Calculated from 6 September, closing at 17:30.

Ms af Jochnick's assessment is that neither developments in Sweden nor abroad have changed substantially since the monetary policy meeting in September. The economic upturn abroad is continuing. Global trade is growing and the labour market is improving in many countries. Global inflation remains subdued, but is expected to rise going forward as a result of increased resource utilisation. As before, it is noted that wage developments in many countries have been subdued, but the conditions are right for rising wage increases in several countries, including Germany.

Although most areas are developing well and in line with the Riksbank's forecasts, there are still, according to Ms af Jochnick, some storm clouds that could have a negative effect on developments. There is still political and financial uncertainty in several parts of the world. In the United States this concerns the possibility to implement reforms in a number of areas in a politically uncertain situation. It is also a question of tendencies towards increased protectionism and geopolitical risks that could develop into global problems. In addition, there are risks linked to the stability of the European banking system and the effects of the Brexit negotiations. She said that all of these risks are difficult to quantify, but could potentially affect global growth and ultimately the possibility to bring up inflation.

Ms af Jochnick also said that economic activity in Sweden is strong, that resource utilisation is thought to be higher than normal and that inflation is close to the target. Although GDP growth for the second quarter has been revised down somewhat, both domestic demand and exports are looking strong. The Swedish economy is now receiving a boost from increasingly strong growth abroad, not least in the euro area, which will be beneficial for Swedish export companies. GDP growth in Sweden is expected to slow down from almost 3 per cent this year and next year to around 2 per cent in 2020. The slowdown towards the end of the forecast period is due to growth in Sweden's export markets slowing down and to housing investments falling somewhat. However, Ms af Jochnick sees a risk that today's high level of housing construction will decline rapidly and in a potential risk scenario could contribute to, or reinforce a future economic downturn. She said she would return to the risks on the housing market later on.

With regard to inflation in Sweden, Ms af Jochnick noted that the outcome for the CPIF was 2.3 per cent in September. Goods prices are showing relatively weak development and rising less than the average rate of change since 2000, at the same time as service prices have increased in recent months much faster than the historical average. As service prices are affected to a greater extent by domestic demand than goods prices, this indicates that the strong economic activity now is having a clearer impact on inflation. At the end of 2017 and beginning of 2018, inflation is expected to fall back slightly. This is due to a decline in the rate of increase of the price of package holidays, lower contributions from energy prices and to the stronger krona.

However, Ms af Jochnick considers that the conditions are right for inflation to remain close to 2 per cent during the forecast period. The expansionary monetary policy has contributed to resource utilisation rising and being expected to be higher than normal going forward. This contributes to a gradual rise in the rate of wage increase, although the upturn is expected to be moderate according to the draft Monetary Policy Report. The stronger economic activity also means that it will be easier for companies to raise their prices. In addition, increasingly strong economic activity abroad is contributing to international prices rising at a faster pace. However, the krona is expected to strengthen further during the forecast period, which will give a counteracting effect by dampening import prices. All in all, the inflation forecast is almost unchanged compared with the assessment in September. CPIF inflation is expected to fall back slightly in the immediate future, and then to stabilise close to 2 per cent over the rest of the forecast period.

With regard to the shaping of monetary policy, Ms af Jochnick said it is important that broader cost pressures in the Swedish economy become clearer before beginning a normalisation. The development of the krona also plays an important role in the assessment of inflation. This means that monetary policy in Sweden cannot clearly deviate from the monetary policy conducted abroad. The Riksbank does not want to risk an overly rapid or strong appreciation of the krona having negative effects on inflation and growth in Sweden. It is therefore important to analyse and take into account decisions by other central banks during the autumn. It is particularly important to see what decisions the ECB takes.

Ms af Jochnick’s overall assessment is that monetary policy needs to remain expansionary to safeguard the role of the inflation target as anchor for the Swedish economy. She shares the assessment in the draft Monetary Policy Report that the door should be left open for a possible extension of the bond purchase programme in 2018.

Ms af Jochnick also said that the Riksbank has been pointing out for several years now that the functioning of the housing market requires improvement, to deal with the high level of household indebtedness. For instance, the Riksbank has pointed out that the construction of housing has been too low and that levels of taxation on housing should be reviewed to create better incentives in the market. With regard to construction, housing investment looks to be at a high level both this year and next year, according to the draft Monetary Policy Report. However, according to Ms af Jochnick, it is difficult to assess whether actual and planned new builds correspond to the demand. There is a risk that both demand and supply are based on overly optimistic expectations of incomes and prices. If this is the case, too many, or too expensive, homes may be built in relation to households’ long-term income growth. If the supply of new housing does not match the demand from the groups and regions in greatest need of housing, this could lead to several consequences. An increased gap between supply and demand could lead to a fall in housing prices. A slowdown in housing construction could moreover contribute to deepening a future recession. There is therefore every reason to carefully monitor future developments on the housing market.

Ms af Jochnick also felt that the high level of housing construction raises questions regarding risks to the financial system. Risks regarding overproduction of housing and falling housing prices are closely linked to credit growth, indebtedness and financial stability. Given that Swedish banks account for around 70 per cent of housing funding and that a not insignificant share of this funding is through covered bonds in foreign currency, problems on the housing market could also spread to the financial system. According to Ms af Jochnick, a long-term sustainable development in the Swedish economy therefore requires a combination of measures in different policy areas.

Governor **Stefan Ingves** began by noting that no crucial changes have occurred since the meeting in September with regard to the economic outlook and inflation prospects. Consequently, Mr Ingves shares the view of economic developments abroad and in Sweden as presented in the draft Monetary Policy Report and he supports the draft monetary policy decision. The same applies to the proposal to extend the foreign exchange intervention mandate.

The recovery abroad is broadening to more and more countries and regions and global trade is increasing. In the United States, the economy is in an expansionary phase that seems to be unusually long in an historical perspective, which Mr Ingves returned to later on in his comments. In the euro area, the recovery is becoming increasingly clear and covering more countries, and optimism among households and companies is high. But there are still political and financial risks in several countries. The recovery is also spreading to more and more emerging market economies, even if the rate of growth varies substantially among, for example, the important BRICS countries (Brazil, Russia, India, China and South Africa). Overall, in the draft Monetary Policy Report, GDP growth in the countries that are most important for the Swedish economy (KIX-weighted) is expected to be just over 2.5 per cent this year and then gradually slow down in the coming years. Inflationary pressures abroad are still quite subdued but are expected to increase slightly in the period ahead. KIX-weighted inflation is expected to be just under 2 per cent this year and rise to just over 2 per cent during the forecast period.

In Sweden, economic activity is strong, partly as a result of an expansionary monetary policy and the recovery on Swedish export markets, Mr Ingves continued. He mentioned that both domestic demand and foreign trade are expected to contribute to good demand in the period ahead, according to the draft Monetary Policy Report. But growth on the export markets is expected to increase a little more slowly and the contribution made by housing construction is forecast to decrease.

Inflation in Sweden has been on an upward trend since 2014. During the spring and early summer (April, May, June), inflation was close to 2 per cent and the last three months (July, August, September), it has been a few tenths over 2 per cent. Inflation expectations are now close to 2 per cent according to all measures and one, two and five years ahead. Fulfilment of the inflation target is, in other words, currently good. According to Mr Ingves, a much greater level of precision than is currently the case cannot be expected. The forecast for the CPIF in the draft

Monetary Policy Report is largely in line with the forecast in the September Monetary Policy Report. The strong economic activity is now having an impact on the rate of price increases. Inflation has also been affected by rapidly increasing service prices, some of which are deemed to be of a temporary nature. Inflation is expected to fall back slightly in the period ahead but stay close to 2 per cent during the forecast period.

Mr Ingves continued by saying a few words about the risks associated with developments abroad. One year ago, the uncertainty largely concerned Brexit and political uncertainty in Europe. The latter seems to have been abating for a time. But now there is renewed uncertainty in some countries that is difficult to assess. In addition, the political uncertainty is still very much about Brexit and its consequences for Europe and about economic policy in the United States after the election of Donald Trump as President. There are also geopolitical risks that are always difficult to assess. It is also noticeably that financial markets are not really able to price in this political uncertainty. Rising equity prices and low volatility on asset markets suggests this. It seems as though political risks are only priced once the high-risk event has occurred, something that could also suddenly shake up market developments and economic policy.

Another central issue concerns the economic recovery in the United States, which has now been going on for a long time. The latest recession ended in June 2009 according to the National Bureau of Economic Research's (NBER's) Business Cycle Dating Committee. The fact that the current economic boom has been going on for so long in the United States may perhaps suggest that a downturn is most likely to start there. There are also studies showing that, in the United States during the period 1854 – 1938, the likelihood of a recession in the United States increased the longer the expansion had continued. After the Second World War, however, the same pattern is not visible. During the post-war period, the likelihood of an economic recession was not so much affected by the length of the expansionary phase, Mr Ingves said.

Often, an economic slowdown is triggered by inflation taking off and central banks needing to cool down the economy via rate hikes. An important change after the financial crisis is that the potential growth rate seems to have subsided in several countries, including the United States. This means that output gaps, all other factors being equal, are closed at lower growth figures than before the crisis, while inflationary pressures have been low. In addition to this, the global long-term real interest rate has shown a falling trend in recent decades, due in part to demographic factors.

These and other changes after the financial crisis, in Mr Ingves' view, are making it difficult to forecast the relationship between monetary policy and economic developments in all countries, including the United States. In the current upturn phase, American growth has been moderate in an historical perspective, without any rapidly rising inflationary pressures. The upward trend in core inflation has been broken, but probably only temporarily. In the draft Monetary Policy Report, the Federal Reserve is expected to stick to its plan of gradually making monetary policy less expansionary. But normalisation of monetary policy is slow in the United States. This economic upswing is not normal. As Mr Ingves said at the beginning, he agrees with the forecast in the draft Monetary Policy Report but at the same time, uncertainty increases the longer the economic upturn in the United States continues.

A third central issue for monetary policy in Sweden is the development of the krona, as it affects inflation. It is important that the exchange rate really does appreciate slowly in the years ahead, as forecast in the draft Monetary Policy Report. But it is genuinely difficult to make exchange rate forecasts, especially when there is uncertainty regarding how the exchange rate is affected by the monetary policies of the major central banks.

The ECB is maintaining the expansionary focus of its monetary policy, Mr Ingves continued. It has communicated that asset purchases will continue until a lasting improvement in inflation prospects is seen. Many market participants are expecting asset purchases to continue next year, but at a slower pace. If monetary policy in Sweden were to be made less expansionary and deviate from monetary policy abroad, the krona would risk appreciating far too quickly and contribute to holding back inflation and growth in Sweden. A slow, gradual readjustment of monetary policy, in line with the forecast for the repo rate in the draft Monetary Policy Report, is reasonable. At the same time, as monetary policy is pulling in different directions in the United States and Europe, the Executive Board will certainly need to discuss on a number of occasions how the detailed design of Swedish monetary policy should be positioned between the Fed and the ECB. Here, Mr Ingves is referring to monetary policy in its entirety, including government bond purchases and the liquidity surplus they create.

Mr Ingves supports Finansinspektionen's proposal regarding tighter amortisation requirements next year, and thinks that it is a highly reasonable measure. But he underlined that this is not enough. Measures are required in several areas. For example, the implementation of structural reforms to improve the functioning of the Swedish housing market is a matter of urgency. Such reforms should not be seen in a short-term business cycle perspective. It is rather the case that the lack of reforms poses a risk to the long-term stability of the Swedish economy. With only the business cycle in mind, there is a risk of structurally important measures never being implemented as it is never quite the right time in the cycle.

Mr Ingves concluded his comments by reiterating his support for the proposal in the draft Monetary Policy Report to hold the repo rate unchanged at –0.50 per cent and the forecast that the repo rate will remain at this level until mid-2018, when slow increases will be initiated. As the current government bond purchasing programme is continuing until the turn of the year 2017/2018, Mr Ingves thought that it gives the Executive Board the chance to await further information that may influence a decision in December to possibly extend purchases. Examples of such information include near-term inflation outcomes and the decisions of other central banks.

Deputy Governor **Henry Ohlsson** began by supporting the proposal to hold the repo rate unchanged at -0.50 per cent. However, he did not support the proposal to extend the mandate to intervention on the foreign exchange market.

To begin with, Mr Ohlsson noted that the economic situation abroad is a healthy one. Global trade is increasing, and in recent months, the pace has also picked up. Annual growth abroad, KIX-weighted, is expected to amount to around 2.5 per cent in the period ahead according to the forecast in the draft Monetary Policy Report. Inflationary pressures are indeed low, but aggregate KIX inflation is expected to be just above 2 per cent during the forecast period. This means that there are expectations of a less expansionary monetary policy abroad. The KIX interest rate is expected to rise, albeit at a slow pace. Government bond yields have increased in the United States and the United Kingdom.

Furthermore, Mr Ohlsson noted that the rate of increase in CPIF inflation amounted to 2.3 per cent in the most recent inflation reading from September. The corresponding reading for September 2016 was 1.2 per cent. CPIF inflation has been around the inflation target for a number of months now. In the last six months, CPIF inflation has been in the interval 1.9–2.3 per cent. According to the forecast in the draft Monetary Policy Report, inflation will be close to 2 per cent in the coming years.

Mr Ohlsson noted that the October reading of five-year inflation expectations among money market participants was 2.1 per cent. Over the last 22 months, five-year inflation expectations have been 1.9 per cent or higher. He also noted that the impression that inflation expectations are now back at the two-percent target is strengthened if we look at expectations two years ahead. In October, these were also at 2.1 per cent. Looking back, two-year inflation expectations have been 1.9 per cent or higher for the last ten months. Finally, one-year inflation expectations in October were at 1.9 per cent or higher for the second month running. This is the first time this has happened since October-November 2011.

He further noted that GDP (calendar-adjusted) is expected to grow by 3.1 per cent in both 2017 and 2018 according to the assessment in the draft Monetary Policy Report. These are historically high figures. The number of hours worked (also calendar-adjusted) is calculated for both years to increase by about 1.5 per cent.

Mr Ohlsson noted that, according to the most recent labour force surveys (LFS) in September, unemployment stood at 6.2 per cent (not seasonally adjusted). This is roughly the same level as the corresponding month one year earlier, when it was 6.1 per cent. He also noted that unemployment insurance fund members can be considered to be in a relatively strong position on the labour market and that the proportion of open unemployed fund members was 2.4 per cent in September. It is also on approximately the same level as in September one year ago, when the proportion of unemployed insurance fund members was 2.3 per cent. Mr Ohlsson thought that it is difficult to escape the conclusion that unemployment seems to have bottomed out. The unemployment figures in August also suggest this.

In Mr Ohlsson's opinion, however, unemployment is still on too high a level. The question he asks himself is: Is it possible to reduce unemployment still further with general demand side policies? Mr Ohlsson's assessment of the current situation is that the increasing demand for labour is causing labour supply to rise rather than unemployment to fall. He therefore asks himself the question whether general demand side policies are approaching the end of the road when it comes to reducing unemployment. If so, it will be even clearer that it is up to other policy areas to bring down unemployment. In such a situation, according to Mr Ohlsson, there are basically two ways of increasing demand for the labour force that is without work: either we increase productivity among the unemployed by training them or we reduce the costs of employing them, for example via subsidies or lower payroll taxes. These are measures that we can realistically believe can be implemented.

The increasingly flexible labour supply is also, according to Mr Ohlsson, an important explanation for the fact that increased resource utilisation is not currently leading to the same rapid increase in nominal wages as before. This change does not just apply to Sweden but is a topical matter for discussion in most advanced economies. In Mr Ohlsson's opinion, an increasingly flexible labour supply is an important explanation for why the correlation between resource utilisation and nominal wage increases has become weaker.

He sees three key causes of the increased and more flexible labour supply. The first is globalisation and increasing economic integration. Globalisation and thereby rising trade is increasing the labour supply in an indirect way. Economic integration within the EU does this in a direct way as a result of the free movement of labour within the Union. Many utilise the opportunities provided by free movement – some by moving permanently, others by working temporarily in other countries within the Union.

The other cause, according to Mr Ohlsson, is technological development. The electronic revolution has not only increased productivity but also made teleworking possible. This occurs not only inside Sweden but also in the form of teleworking from other countries in organisations in Sweden. Teleworking can be part-time when economic activity is low, and then be full-time when activity is high.

The third cause highlighted by Mr Ohlsson has to do with changes of institutions in a broad sense. A concrete Swedish example is that more and more collective agreements contain agreements on working time "banks". According to these agreements, the number of hours worked for an employee can be redistributed over the business cycle. Another example is the emergence of temporary employment agencies in Sweden. From once upon a time being illegal, the industry is currently about 80,000 strong.

Mr Ohlsson also noted that in Sweden we have seen greater labour supply among older people. According to the LFS for the third quarter of 2017, almost four per cent of those employed were between 65 and 74 years old. One can assume that their labour supply is very flexible.

Mr Ohlsson's conclusion is that if we put all these part-explanations together, it is not so strange that the correlation between resource utilisation and nominal wage increases has weakened. At the same time, his assessment is that there is still a correlation. Recent developments have also shown that it has been possible to bring up inflation to the target despite only moderate nominal wage increases. Wages are not the only driver of inflation.

Against the backdrop of this reasoning, Mr Ohlsson then talked about his monetary policy considerations. He pointed out that monetary policy cannot be guided by a few tenths above or below 2-percent inflation. We then end up in what Mr Ohlsson has previously referred to as "the tyranny of the tenths". For every month that passes with inflation close to 2 per cent, he sees that we are approaching the point at which monetary policy should start to be normalised.

Mr Ohlsson reminded everyone that, at the monetary policy meeting in April 2017, his opinion was that the repo-rate path should be formulated to predict that repo rate rises would begin to be initiated at the beginning of 2018. Against the backdrop of Mr Ohlsson's contributions at today's meeting, he said that he is still of the same opinion. At the meeting in April, he refrained from enter a reservation on this point and he did not intend to do so at this meeting either. The reason that Mr Ohlsson gave was that the repo-rate path is a forecast, not a direct monetary policy decision.

Finally, Mr Ohlsson noted that a rapid appreciation of the krona can make it more difficult to fulfil the inflation target. This was the background to the decision by the Executive Board on a mandate for the Governor and the First Deputy Governor to intervention on the foreign exchange market. The decision, which Mr Ohlsson supported then, was made in a situation in which inflation and inflation expectations were far below the target. He pointed out that the current situation is different. With inflation and inflation expectations close to target, his opinion is that issues related to possible interventions on the foreign exchange market can be managed without a special mandate.

To sum up, Mr Ohlsson supported the proposal to keep the repo rate at –0.50 per cent. However, he did not support the proposal to extend the mandate for foreign exchange interventions.

§3. Discussion

Deputy Governor **Cecilia Skingsley** began the discussion by commenting on two things, firstly the question of an extension of the bond purchase programme and secondly the question of deviations in inflation that was also taken up by Deputy Governor Jansson.

With regard to the question of a possible extension of the bond purchase programme, Ms Skingsley said that it would not have been a well-founded decision if the Executive Board had made the decision at today's meeting. She felt that buying bonds entailed increasing risks to the Riksbank’s balance sheet, which meant that the base for making a decision was very important. Given that the Riksbank is close to fulfilling its target, there is time to wait until the December meeting, when further information is available.

With regard to the question of deviations from the Riksbank’s inflation forecasts, Ms Skingsley wished to emphasise that she still regards inflation outcomes that are below the forecast as a potentially greater problem than the opposite, given the long period during which inflation was too low and inflation expectations were drifting. She also pointed out that tolerance for inflation outcomes higher than 2 per cent should not be perceived as the Riksbank moving towards a price level target, nor that she would advocate such a regime. To begin with, the preliminary works to the current Sveriges Riksbank Act are clear. They state that monetary policy should not compensate for earlier deviations from the target, which would happen if the Riksbank steered according to a price level target.

Ms Skingsley also observed that while a price level regime could appear attractive in theory, in practice it would be difficult to implement. The attractive part is that if inflation has been too low and the policy rate is close to its lower bound, then in a price level regime the economic agents “know” that monetary policy will become so expansionary that it compensates for the earlier low inflation. With this knowledge, inflation expectations could rise substantially in the short term. This would in turn entail a lower real interest rate, which would benefit demand in the short run. On the other hand, long-term inflation expectations might at the same time need to be rational, that is, anchored at the central bank's price level target. Otherwise, inflation would risk becoming far too high, driven by economic agents’ short-term inflation expectations. According to Ms Skingsley, this means that difficulties could arise in the practical application of monetary policy. She felt that for a price level regime to function, the economic agents would need to have adaptive expectations in the short term and rational expectations in the long term.

Ms Skingsley further claimed that the reverse situation is difficult to operationalise. If one assumes that inflation has been too high for a while, the central bank will therefore need in a price level regime to raise the policy rate to push down inflation below the target, with the result that inflation expectations in the short term would need to be low or even deflationist to restore the price level trend. The risk is then that inflation expectations would become entrenched at a level that was too low, to the detriment of growth, employment and monetary policy's ability to stabilise inflation.

Deputy Governor **Martin Flodén** returned to the discussion of the high level of housing construction mentioned by several of the other Board members in their comments. He referred back to the risks of overproduction mentioned by First Deputy Governor Kerstin af Jochnick. He also sees this type of risk. Historically, severe economic downturns have often been preceded by a period with a rapid rise in construction. In Sweden, housing investment has increased from around 3 per cent of GDP in the past two decades to almost 6 per cent now. But at the same time, said Mr Flodén, it is necessary to point out that 6 per cent of GDP is not a remarkably high level. It is only marginally higher than a normal European level and much lower than levels of around 12 per cent of GDP that were the case in Spain and Ireland prior to the most recent financial crisis. As already mentioned, a level of construction around the current levels is needed, after the long period with a low level of construction, and because Sweden is experiencing a rapid growth in population. This is supported by most analyses of the housing need going forward, for instance, the National Board of Housing, Building and Planning’s assessments.

Mr Flodén said that his concern was not actually about the level of construction, but rather the fact that activity in the construction sector has changed so rapidly and the driving forces behind the upswing in construction. He asked himself whether the new construction was based on incorrect assessments of the type of housing in demand and on overly optimistic forecasts of continued price rises. Can the market maintain this level of construction even if prices cease rising so fast? A large fall in construction would jeopardise economic activity and risk making the forecast in the draft Monetary Policy Report obsolete, as well as bringing to a halt the process towards a better balance between supply and demand on the housing market.

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

The Executive Board decided

• to adopt the Monetary Policy Report with the proposed editorial amendments, Annex A to the minutes, and

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

§5. Other decisions

The Executive Board decided

• to publish the Monetary Policy Report and decisions under Section 4 with the motivation and wording contained in a press release at 09.30 on Thursday 26 October 2017, and

• to publish the minutes of today's meeting on Thursday 09 November 2017 at 09.30.

This paragraph was verified immediately.

Minutes taken by

Lena Eriksson

Verified by:

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

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