Monetary policy minutes

September 2017

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

Summary

At the monetary policy meeting on 6 September 2017, the Executive Board of the Riksbank decided to change the target variable for monetary policy from the CPI to the CPIF and to start using a variation band to illustrate that the development of inflation is uncertain. It also decided to hold the repo rate unchanged at –0.50 per cent. The first rate increase is expected to occur in mid-2018, which is the same assessment as in the Monetary Policy Report in July. The purchases of government bonds will continue during the second half of 2017, as decided by the Executive Board in April.

The Executive Board agreed on the picture of economic development and the inflation outlook described in the draft Monetary Policy Report.

Economic activity abroad continues to strengthen but inflation is subdued. Normalisation of monetary policy around the world appears to be taking longer than expected.

The Executive Board noted that the Swedish economy is strong and welcomed the fact that inflation, after a long period below the target, has now picked up and is close to 2 per cent. But there are some temporary factors behind the most recent upturn in inflation and the krona has strengthened more rapidly than in the forecast in July.

Several board members pointed out that a very expansionary monetary policy has been required to bring up inflation and that it would be risky to now make monetary policy less expansionary. For inflation to stabilise around the target, economic activity needs to remain strong and have an impact on price growth. The development of the krona is also of considerable significance for inflation. A major or rapid appreciation of the krona would make it more difficult to stabilise inflation around the target. This could happen if, for example, Swedish monetary policy deviates too far from that of other countries.

Several board member highlighted the issue of overheating in the Swedish economy and noted that there are currently no clear signs of this as neither prices nor wages are rising in an unbalanced way. But developments in the housing sector require particular attention. The high level of household indebtedness is something that the Riksbank has been worried about for a long time. Debt has been rising for a long time, even when interest rates were higher, as a result of structural problems. Imbalances have thus been built up and this creates risks for the Swedish economy. After a long time with inflation and inflation expectations below target, however, monetary policy needs to focus on safeguarding the inflation target.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 4

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DATE: 06/09/2017

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

Jan Alsterlind
Mattias Ankarhem
Carl-Johan Belfrage
Claes Berg
Sophie Brauner
Meredith Beechey Österholm
Carl Andreas Claussen
Hans Dellmo
Charlotta Edler
Mattias Erlandsson
Jens Iversen
Jesper Johansson
Ola Melander
Pernilla Meyersson
Ann-Leena Mikiver
Jonas Niemeyer
Christoffer Nordenlöw (§ 1-4A)
Maria Sjödin
Ulf Söderström
Anders Vredin

It was noted that Mattias Ankarhem and Carl-Johan Belfrage would prepare draft minutes of the monetary policy meeting.

§1. Decision on target variable and variation band

The Executive Board decided in accordance with the proposal, Annex A to the minutes.

§2. Economic developments

Christoffer Nordenlöw from the Markets Department began by presenting the latest developments on the financial markets. The escalating geopolitical uncertainty on the Korean Peninsula seems so far not to have had any lasting impact on market pricing. Despite relatively good statistics and indicators, long-term government bond yields are still low. Above all, yields are burdened by subdued expectations regarding near-term reductions in the bond holdings of the major central banks. As far as Sweden is concerned, good macroeconomic statistics and indicators have helped to slightly increase the spreads in relation to German yields in recent weeks. Since the monetary policy meeting in July, the US dollar has weakened against both the euro and the Swedish krona. The reasons for this include subdued expectations about US fiscal and monetary policy as well as stronger-than-expected macroeconomic data for both the euro area and Sweden. The Swedish krona has also appreciated in trade-weighted terms. Prior to today's monetary policy meeting, the vast majority of analysts expect the Riksbank to keep the repo rate unchanged and to increase the rate at some point in 2018. Most believe that the first increase will come in the first half of the year, i.e. slightly earlier than indicated by the interest rate path in the July forecast. No new communication regarding asset purchases is expected. Some analysts believe that a decision will be taken about a new target variable and that a variation band stretching between 1 and 3 per cent will start to be used.

Anders Vredin, acting Head of the Monetary Policy Department, began by noting that the forecasts and monetary policy assumptions have been discussed with the Executive Board at meetings on 22, 23 and 29 August. At a meeting with the Executive Board on 31 August, the draft Monetary Policy Report was discussed and tabled.

Mr Vredin then presented the draft Monetary Policy Report, which the Monetary Policy Department deemed would gain the support of a majority of the Executive Board members. An important prerequisite for how the Swedish economy performs is what happens abroad. During the year, global economic activity has grown stronger, in line with the Riksbank's forecasts, and global trade has increased. But even if the signals about economic activity abroad are good, global inflation is subdued and normalisation of monetary policy abroad appears in general to be progressing slowly. Unexpectedly low inflation outcomes in the US have contributed to reducing expectations regarding the Federal Reserve and expectations regarding the ECB's monetary policy have followed suit. The downward shift in monetary policy expectations in the UK is explained by worse-than-expected statistics and greater fears for a "hard Brexit".

Mr Vredin then focused on this summer's outcomes for the Swedish economy, some of which are difficult to interpret. GDP growth in Sweden was unexpectedly strong in the second quarter but the outcome is based on a preliminary version of the National Accounts and is therefore more uncertain than usual. Moreover, the outcome is deemed to have been affected by temporary factors, causing a slight revision of the forecast for the third quarter. Overall, however, growth in 2017 is expected to be higher than in the forecast presented in the July Monetary Policy Report. This is also true for 2018, mostly as a result of the Government having announced a more expansionary fiscal policy than the one in the previous assessment. Despite the unusually strong growth, unemployment rose to an unexpectedly high level in July. This statistic tends to be particularly uncertain during the summer, however. Some of the recent variation in unemployment outcomes can also be attributed to estimates of the level of unemployment among foreign-born persons, which is relatively difficult to determine. Unemployment is now expected to fall back in August and September and later on is predicted to be lower than in the July forecast due to both higher employment, as a result of higher GDP and demand, and lower labour supply. The Swedish Migration Agency has revised down its forecast for the number of granted residence permits.

Mr Vredin also noted that inflation was unexpectedly high in July. Measured in terms of the KPIF, it amounted to 2.4 per cent after surprisingly high service and energy price figures. Although a change in the way package holiday prices are measured, along with temporarily high air travel prices, suggest that it is partly a question of temporary factors, stronger demand means that inflation is nevertheless expected to be slightly higher in the period ahead than previously estimated.

The krona exchange rate is important for the development of inflation and the krona is approximately 3 per cent stronger than in the July forecast. The assessment is that this is partly explained by unexpectedly strong Swedish macro data. The krona appreciation is therefore partly a symptom of expectations of higher Swedish inflationary pressure.

Deputy Governor **Per Jansson** asked for a closer analysis of the consequences of an appreciation of the krona and what various scenarios for the forthcoming normalisation of monetary policy in Sweden and abroad might mean for the development of the krona exchange rate. He pointed out that there may be cause for concern regarding that part of the krona appreciation that is not based on the macro figures having been stronger in Sweden than in other countries.

Governor **Stefan Ingves** interjected that since the krona appreciation can probably exert further downward pressure on goods prices, it therefore means that inflation close to the target requires unusually rapidly rising prices for services.

Anders Vredin agreed that these are important issues and concluded by presenting a few important themes discussed in the drafting process.

One theme has been how to interpret the high GDP figures. How much is temporary and how much suggests a different trend? Should the high GDP outcome be interpreted as high demand or high supply? Depending on the interpretation made, the consequences for the inflation forecast will be different. Productivity has been unexpectedly strong, which might suggest low inflationary pressure. But the high productivity is a reflection of the unexpectedly weak development in the number of hours worked. The figures on hours worked are uncertain, however, making the productivity figures uncertain, too. On the other hand, there are many indications that demand is high. All in all, the assessment is that demand is higher than in the July forecast, which means that wages and inflation have been revised upwards somewhat.

Another theme has been the interpretation of the surprisingly high inflation figures. How much of the surprise is temporary and how much suggests a higher trend? The assessment is that just over half of the surprise has to do with temporary factors while there are also signs of higher underlying inflation.

A third theme has been the above-discussed interpretations of the krona appreciation since the monetary policy meeting in July.

A fourth theme has been the issue of overheating in the Swedish economy. So far, really high levels of demand and resource utilisation have mostly occurred in certain individual sectors. The low cost pressures in the economy suggest that there is currently no general overheating. The Riksbank still needs to be vigilant about possible symptoms of overheating, however, both in the economy as a whole and in individual sectors.

§3. The economic situation and monetary policy

Deputy Governor **Per Jansson** began by noting that the inflation picture has continued to improve since the monetary policy meeting in July. Two new inflation outcomes have been published, for June and July. Just as for April and May, both outcomes were higher than expected. For July, CPIF inflation was just under 2.4 per cent, which can be compared to a forecast of about 1.8 per cent. As energy prices are still making positive contributions to inflation, the outcome for CPIF inflation excluding energy prices was slightly lower at just above 2.1 per cent. The expected outcome here was 1.7 per cent. As regards the major forecast error for July, it may be worth pointing out that market forecasts made just before the outcome was published also fairly substantially underestimated the development of inflation.

Mr Jansson stressed that an important reason why inflation has started to pick up in recent months is service price developments having become quite significantly stronger. It was already clear that this had happened at the monetary policy meeting in July. In March, prices for services increased by a moderate 1.2 per cent. The corresponding rates of increase in April and May were 2.3 and 2.4 per cent respectively. And now, developments have accelerated further, to 2.8 per cent in June and no less than 3.2 per cent in July. Although the upturn is considered to be partly the result of temporary factors, we have to go back to the beginning of the 2000s to find as high a figure for service price inflation. The development is pleasing, of course, but it also makes clear that the Riksbank is currently highly dependent on rapidly rising service prices in order to be able to stabilise inflation close to the inflation target. And this task will not become easier going forward, when the krona exchange rate starts to have a restraining effect on inflation, he observed.

Mr Jansson pointed out that the development of inflation expectations is also an important reason for the improvement in the inflation picture. Here as well, two new outcomes have been published since the last monetary policy meeting, Prospera's monthly survey of money market participants in July and August. The outcomes show that expectations continue to display a rising trend on all surveyed time horizons. As regards inflation expectations two and five years ahead, the deviations from the inflation target continue to be very small. At the same time, one-year expectations have recently risen rapidly and are now for money market participants slightly above 1.8 per cent. This is the highest reading for one-year inflation expectations among money market participants since November 2011.

He noted that, against the backdrop of the surprisingly high inflation outcomes, it is now proposed in the draft Monetary Policy Report to revise the forecast upwards over the coming year for both CPIF inflation and CPIF inflation excluding energy prices. After the middle of 2018, however, the proposed forecast adjustments for both inflation measures are minor. Certainly, the starting point is now that GDP growth and resource utilisation will be higher than previously expected over the next few years. Normally, this gradually leads to slightly higher inflation. But the fast growth is driven by strong productivity developments, which is holding back cost pressures in the economy. The unexpectedly significant appreciation of the krona exchange rate during the summer months is also contributing to subduing the outlook for inflation in the period ahead. Overall, these effects cancel each other out and the forecast changes are therefore small.

Mr Jansson acknowledged that the proposal to revise up the inflation forecast for next year but leave it basically unchanged after that means that inflation is now expected to be close to 2 per cent during the entire forecast period. Although a certain slowdown in price growth is expected during the rest of this year until the spring next year, CPIF inflation will stay close to target and bottom out no lower than around 1.7 per cent in early 2018. He supported this assessment of inflation developments and other forecasts made in the draft Monetary Policy Report. He also supported the assumption for monetary policy on which these forecasts are based and said that it is important in this context to underline the close link that here prevails between monetary policy and inflation – the development of inflation that has been forecast presupposes a continued, markedly expansionary monetary policy, in line with the interest-rate path presented in the draft report.

The strong economic situation in Sweden has led to the word overheating cropping up from time to time recently, Mr Jansson continued. According to the Swedish financial daily Dagens Industri, for example, even myopia-sufferers can now see overheating tendencies in Sweden and a number of members of the "Shadow Executive Board" already want to start increasing the interest rate at today's monetary policy meeting, with reference to, among other factors, a high level of resource utilisation.[1] His impression is, however, that even if these voices are often quite prominent in the debate, they nevertheless are an exception. It is normally not a question of considering the Swedish economy already overheated but of identifying a risk of this being the case within the not-too-distant future. Whether, and if so how soon, the economy runs the risk of overheating is of course a very important question. The assessment made by Mr Jansson, when he weighs up the arguments, is that there is still some time left before there is seriously a reason to worry about this.

What is traditionally meant by overheating is that demand is so strong and resource utilisation in the economy so high that wage growth and inflation start to spiral upwards. In such a situation, monetary policy may need to be tightened quite quickly and considerably so as not to lose control over price and wage developments. When one is forced to apply the brakes in this way, the risk of setbacks in the real economy also tends to increase. However, Mr Jansson finds it difficult to believe in any real "ketchup effect" for inflation, partly because inflation has increased slowly to the levels it is at today, despite the Riksbank having conducted an expansionary policy for a relatively long time, and partly because there is currently only moderate wage growth. Bottlenecks will no doubt occur in certain areas, but his current assessment is that the risk of general overheating in the Swedish economy is not so great as to warrant any changes in either actual or expected monetary policy. Also relevant in this context is that the Executive Board of the Riksbank has made it clear that it can tolerate an inflation rate that is temporarily slightly higher than the inflation target.

The development of debt and housing prices is an issue that, according to Mr Jansson, has to be discussed separately from the issue of a general overheating of the economy. Housing prices and debt have shown a rising trend for a long time and the repo rate has been both quite high and very low during this period. This is a clear indication that the problems on the housing market are largely structural. In Mr Jansson's view, the ongoing debate often incorrectly gives the impression that the problems of rising debt and housing prices would essentially be solved if only the Riksbank abandoned negative interest rates. But real interest rates have been falling around the world for several decades and are currently very low. This is not something central banks can influence, but they have to take into account the low real interest rate when they conduct their monetary policy. It also means that in a normal monetary policy situation, and even when

[1] Dagens Industri's "Shadow Executive Board" is a group of six economists and analysts that undertakes an artificial vote on monetary policy ahead of each monetary policy meeting of the Riksbank.

monetary policy is contractionary, interest rates will be unusually low. This too suggests that monetary policy is not a particularly appropriate tool with which to manage the problems on the housing market.

Mr Jansson wished to conclude by briefly commenting on the three conditions that he launched at the last monetary policy meeting for starting to discuss a phase-out of the very expansionary monetary policy. The first, and clearly the most important condition, is the need for the more underlying inflation rate to remain close to 2 per cent for several months. As only a couple of months have passed since the meeting, it is of course no yet possible to draw any conclusions as regards this condition. As he has mentioned before, however, inflation has continued to surprise on the upside and is close to target. This is certainly a good start. But, Mr Jansson continued, just as he had pointed out last time, it is a question of passing the important "test" going forward when various temporary effects, energy prices and the krona exchange rate stop having a positive impact on inflation.

The second condition is that the krona exchange rate must not appreciate too quickly and too much. On this point, Mr Jansson feels cause for concern. Since the monetary policy meeting in July, the krona has appreciated significantly faster than expected. Against the euro, the appreciation amounts to just under 2 per cent while against the US dollar, it is more than 6 per cent.[2]

Just as is emphasised in the draft Monetary Policy Report, a krona appreciation occurring as a result of unexpectedly strong economic developments in Sweden is not as problematic as an appreciation that takes place without any other favourable changes in the Swedish economy. The large and rapid appreciation against the US dollar is therefore particularly worrying as it depends to a great extent on negative events in the US economy. In order not to have another unwelcome tightening of Swedish financial conditions, it is of considerable importance going forward that the krona appreciation declines in strength and follows a significantly softer path. If this does not happen, the risk will be imminent of this issue soon becoming an important subject of debate in the Executive Board's monetary policy deliberations, he reasoned.

The third and last condition concerns other central banks, in particular the ECB but also the US Federal Reserve, having to start phasing out their expansionary policies to a greater extent, or at least be more concrete as regards how they intend to do so. Unfortunately, no noteworthy progress has been made on this point either, Mr Jansson said. As of late, both the ECB and the Federal Reserve have more or less maintained total radio silence as regards new clarifying information about how a normalisation will take place. This silence, combined with some negative news, has led to expectations arising on the market of a more expansionary monetary policy in both the euro area and the US, compared with the situation in July. His summary was

[2] Calculated from closure at 17.30 hours on 3 July.

that normalisation of monetary policy abroad is progressing slowly and for the time being, at least if expectations on the market are anything to go by, is actually going in the wrong direction.

Mr Jansson stands by the assessment he made in July that it will be very difficult for the Riksbank to stop new asset purchases entirely at the turn of the year if the ECB continues with further purchases of its own. If the Riksbank chose to take that path and the market is more or less right in its estimate of how the ECB will start to reduce its asset purchases in 2018, Sweden's relative financial conditions would tighten significantly next year. This would, as he now sees it, seriously jeopardise the conditions for the Riksbank to be able to stabilise inflation close to 2 per cent.

Deputy Governor **Martin Flodén** began by supporting the proposal to leave the repo rate unchanged at today's meeting. He also supported the draft Monetary Policy Report and the forecasts contained within it, including the forecast for an appropriate repo rate in the period ahead.

Developments abroad have been in line with the proposal put forward by the Riksbank in early July in connection with the last monetary policy meeting, Mr Flodén noted. Developments in the US economy are thus still strong and economic activity in the euro area is increasing while inflation is still subdued. The most remarkable aspect of economic developments abroad is that the dollar has continued to depreciate against many currencies.

The explanation for the weaker dollar is probably a combination of inflationary pressure being unexpectedly low in the US economy and that previous expectations of a more expansionary fiscal policy do not seem to be realised. Instead, monetary policy is expected to become more expansionary as the Federal Reserve's rate rises occur at a slower pace. As a consequence of this, the euro has strengthened rather considerably against the dollar – by 5 per cent after the monetary policy meeting in July and by 13 per cent this year. The strong euro, in combination with persistently subdued inflation in the euro area, has contributed to the market now expecting a more expansionary monetary policy from the ECB as well. Expectations about both the Fed's and the ECB's monetary policy have therefore shifted in an expansionary direction since the July meeting.

In Sweden, the summer's data outcomes have been strong. Inflation in June and July was significantly higher than the Riksbank's forecast. Most of the surprisingly high inflation seems to have been caused by temporary factors, especially by method changes that have led to a modified seasonal pattern in package holiday prices. If the temporary inflation effects are excluded, the inflation upturn is more modest, but a clear upward trend in underlying inflation can still be seen. This inflation upturn is welcome after the long period of excessively low inflation. It strengthens confidence in the inflation target and may therefore contribute to a reduced need for monetary policy to closely monitor short-term developments in inflation.

The real economy is also continuing to develop strongly, Mr Flodén continued. According to Statistics Sweden's flash estimate, GDP growth in the second quarter was significantly higher than the Riksbank's forecast. Although data outcomes and confidence indicators in recent weeks show a slight weakening, there is still no doubt that Swedish economic activity is strong and resource utilisation is high. Despite the high resource utilisation, it is difficult to see clear signs that the economy in general is overheated. Wage pressure is still fairly weak and the forecast for wage increases in the period ahead has only been marginally revised upwards. Household consumption is not growing worryingly quickly but at a fairly normal pace, and the household savings ratio is high. Public finances are strong and the current account is showing a surplus.

What stands out compared to historical patterns is mainly activities linked to housing and construction. For a long time, the Riksbank has been concerned about the rapid increase in housing prices and household indebtedness. One factor that has contributed to the rising prices, and hence to the higher indebtedness, is the low level of housing construction for several decades. This has changed over the past two to three years, in which construction has increased at a rapid rate. The current high level of construction can contribute to a better balance between supply and demand on the housing market in the long term, according to Mr Flodén, but in the near term he sees the rapid change in the sector's activity level as a cause for concern that requires some vigilance. For example, it is important that the funding of construction projects is not based on calculations that assume continued price increases.

Mr Flodén then elaborated on his monetary policy considerations. He was advocating an unchanged repo rate and repo rate forecast for the period ahead despite both inflation and GDP growth having developed more strongly than in the July forecast. There are primarily two factors leading him to believe that the rate needs to remain at its current level until the middle of next year. The first is, as he has already mentioned, that inflation surprises in recent months seem to be dominated by temporary components. The second is that the gap between Swedish and foreign government bond yields has increased and that the krona has appreciated by approximately 3 per cent during the summer. This has occurred as a result of both strong Swedish data and expectations of a more expansionary monetary policy abroad. The strong krona will hold back inflation next year and also contribute to dampening the economic activity.

Mr Flodén's assessment is that, in this situation, after a modest upward revision of medium-term inflationary pressure, it would be risky to tighten monetary policy over and above the tightening that has already been priced in by the market via the krona's appreciation. Confidence in the inflation target has most likely not been completely restored after the long period of low inflation. If inflation falls back too much over the next six months, the risk is that inflation expectations will once again start to fall in a problematic way and that the Riksbank will therefore instead be forced to postpone rate rises for even longer.

Despite his advocacy of the same rate forecast as at the last monetary policy meeting, he thinks that the uncertainty surrounding this forecast has increased. The latest inflation figures are difficult to interpret, partly because they deviate so much from the forecasts of the Riksbank and others, and partly because experience of Statistics Sweden's new method for measuring package holiday prices is still limited. Inflation outcomes over the coming months will therefore be important when it comes to interpreting inflationary pressures, and may possibly lead to the Swedish inflation upturn nevertheless being deemed to be more persistent than temporary. Were this to be the case, it might suggest that the first repo rate increase could occur slightly earlier than in the forecast.

Two other factors that could justify a slightly less expansionary monetary policy concern fiscal policy and wage growth. The Riksbank's forecast for public consumption next year has been revised upwards after announcements made by the Government prior to the autumn budget. A more expansionary fiscal policy can, depending on how it is designed, lead to higher inflationary pressure. But it is too early to draw monetary policy conclusions from the announcements before there are concrete proposals and decisions about the budget, according to Mr Flodén. The other factor is wage growth. The Riksbank has repeatedly been surprised by low wage growth despite ever-stronger economic activity. Recently, however, there have been certain small signs of an increase in wage drift, and for the first time in nearly two years, the forecast for short-term wages is being revised upwards, albeit only marginally. Clearer indications that wage growth is increasing in line with the strong resource utilisation and in line with the forecasts from last winter and autumn could also justify a slightly less expansionary monetary policy.

But Mr Flodén's assessment is that the uncertainty around the interest rate path has also increased in the other direction, i.e. that the probability of the first rate rise having to be postponed has also increased. This is the result of uncertainty surrounding foreign inflationary pressures and hence surrounding monetary policy abroad. A slower normalisation of the policy rate in the US and continued very expansionary monetary policy in the euro area mean that the krona is tending to appreciate, making early Swedish rate rises less appropriate. This autumn's communication and decisions from the major central banks will clarify the external conditions that surround Swedish monetary policy and that affect the appropriate timing of a first repo rate increase.

Deputy Governor **Cecilia Skingsley** began by supporting the forecasts, the description of the economic situation in the Monetary Policy Report and the proposed monetary policy.

She went on to note that it has taken more time and demanded more far-reaching monetary policy stimulus than forecast to bring Swedish inflation back to a rate close to the target. In striving to fulfil the inflation target, the Riksbank has also, in accordance with the legislator's intentions, been able to support the general economic objectives of sustainable growth and high employment, Ms Skingsley pointed out.

Supported by the international recovery, Swedish growth is expected to be over 3 per cent this year. Since the negative repo rate and bond purchases were introduced in spring 2015, employment in Sweden has increased by almost 200,000 people. The employment rate has risen by 1 percentage point over the same period; similar figures have not been seen since the years prior to the global financial crisis.

As the Monetary Policy Report indicates, the situation with strong Swedish economic activity and inflation close to target still stands. However, one important part of the Riksbank's assessment is that the monetary policy being conducted is left unchanged.

The debate over today's monetary policy decision will largely focus on why the Riksbank is not initiating repo rate rises or at least adjusting the repo rate path towards earlier rises, predicted Ms Skingsley, going on to explain why she did not support such a decision.

She started by reminding the meeting that the debate over the strong growth of the Swedish economy and how monetary policy should react to it could not have taken place if the Riksbank had not persistently striven to deliver target attainment in accordance with its statutory task.

For a small economy, dependent on foreign trade, such as Sweden's, it is vital to have a clear and quantitative economic policy framework, continued Ms Skingsley. This supports international confidence in Sweden and contributes to predictability for economic agents. Soon it will be 25 years since the Riksbank's most important policy rate was 500 per cent, between 17 and 21 September 1992. Unlike today, international confidence in Sweden was at a record low point and room for manoeuvre for economic policy was exhausted. There followed a number of painful years for hundreds of thousands of people in Sweden with lost jobs and worsened living standards. After what became known as the crisis of the 1990s, several other important reforms were launched in a broad sense by the Riksdag and in the form of agreements on the labour market. In a world where much is uncertain, our neighbours must be able to rely on Sweden to take responsibility for sustainable public finances and price stability.

Under the framework of current legislation, the Riksbank has used both the repo rate and an expanded balance sheet to take care of its share of this responsibility, which is to say price stability defined as a rate of inflation of around 2 per cent, observed Ms Skingsley. Persistence is important, she continued. In recent years, when inflation has been below target, many claims have circulated that the Riksbank would be unable to stabilise inflation around 2 per cent again. For example, it has been claimed that globalisation and digital services would nullify the conditions for future inflation. Another example is the claim that negotiators of labour market agreements should disregard the two per cent target in wage formation and a third example is that the Riksbank's bond purchases should not match the European equivalents. As I said, persistence is important, Ms Skingsley repeated.

However, this does not mean that monetary policy lacks problematic side effects, she continued. Low interest rates have also long contributed to growing debt in the household sector and thereby to increased vulnerability in the economy. This is nothing new but something that Riksbank representatives have long warned about, not only when the repo rate was 2 per cent in 2011, but also when it was 1 per cent in 2013, and again now in the latest report. As in previous iterations, the Monetary Policy Report therefore includes sections warning that rising debts are making households sensitive to shocks. Households' high debts and high housing prices are also making the banking system vulnerable and further work is needed to counteract these risks.

Ms Skingsley then returned to the Riksbank's assessment that the current monetary policy with an unchanged repo rate and repo rate path forms a precondition for inflation to stabilise around 2 per cent. But other assessments could also be made, she noted. It would be reasonable to discuss the timing of the initial normalisation of monetary policy and the method for how this could happen. Starting with the method, if an earlier tightening were to be relevant, this would involve adjusting the repo rate. Even though she had entered a reservation against the current bond purchases, Ms Skingsley said that a premature break of these purchases would be a measure with very unpredictable effects. This is because there prevails great uncertainty over the stimulative effects of bond purchases, compared with the effects of an adjusted repo rate or an adjusted forecast for the repo rate.

Ms Skingsley's assessment is that, at present, there are not enough convincing indications to justify an earlier tightening of the monetary policy than the forecast predicts. Considering how much time and powerful measures have been needed to achieve today's inflation rate, it is important to safeguard what has been achieved, she pointed out.

Global macroeconomic developments continue to be positive, but international monetary policy normalisation is proceeding slowly and, since the Riksbank's previous meeting, it is expected to go slightly more slowly yet. The exchange rate is important after the long period of low inflation and the appreciation of the krona could be too fast if the Riksbank's monetary policy were to differ too much from those of other countries, noted Ms Skingsley.

Regarding signs of financial imbalances, Ms Skingsley returned to her previous comment on the problems surrounding the housing market and its interplay with the banking sector, which, in her opinion, is the financial risk factor that could have the greatest impact on the Riksbank's ability to fulfil its task.

In the domestic Swedish macroeconomic environment, Ms Skingsley said that, at present, it is not apparent that there are growing risks for imbalances, more popularly known as overheating. Cost pressures continue to be low and a significant part of the second quarter's surprisingly strong growth can be explained by high productivity, which will contribute to moderate cost pressures in the period ahead. However, tendencies towards growing macroeconomic imbalances need to be monitored and discussed more in the period ahead, Ms Skingsley concluded.

First Deputy Governor **Kerstin af Jochnick** began by saying that she supports the assessments and forecasts made in the draft Monetary Policy Report and that she also backs the proposal to keep the repo rate and the repo rate path unchanged in accordance with the decision at the monetary policy meeting in July 2017. Purchases of government securities will also continue in accordance with the previous decision.

Ms af Jochnick's overall view is that developments abroad and in Sweden are largely in line with the Riksbank's forecasts in July. The economic upturn abroad is continuing. Global trade is growing and the labour market is improving in many countries. But global inflation is still subdued. However, the Riksbank estimates that international inflation will rise in the period ahead as a result of increased resource utilisation.

The strong development on the labour market abroad has so far not contributed to a rapid increase in wages. According to Ms af Jochnick, this may be due to the fact that productivity is low. It may also be due to the low inflation itself restricting wage increases. There is also a risk of a long period of low inflation dragging down inflation expectations. In any case, this raises the question of whether the relationship between high resource utilisation and inflation is not as strong as previously in several countries.

In the US, the economy is continuing to develop well, said Ms af Jochnick, even if some indicators have been slightly lower than forecast. The US government's discussions on changes to taxes, trade agreements and healthcare are creating uncertainty about developments in the period ahead, which may subdue economic activity somewhat. At the same time, employment is rising and unemployment is down at a historically low level. The upturn in the rate of wage increases has been rather moderate, however, and underlying inflation has recently fallen back slightly. But the Riksbank estimates that the upward trend in inflation will continue as unemployment falls and resource utilisation increases.

Ms af Jochnick also noted that the recovery in the euro area is continuing, and both growth and inflation are developing largely in line with the Riksbank's forecasts. In the euro area, there is more spare capacity than in the US and no clear upturn in underlying inflation is expected until 2018. In the years ahead, growth is expected to slow down slightly, but still be sufficiently strong for resource utilisation to continue to rise and unemployment to fall. The outlook is therefore slightly brighter in the euro area now but risks remain as regards indebtedness and coping with vulnerabilities in the financial system, she said.

In addition, how the euro performs in the period ahead will be of considerable significance, not least for the development of inflation. Both the euro and the Swedish krona have appreciated since the summer, partly as a result of strong outcomes for central indicators but also due to a depreciating dollar. The dollar has probably weakened due partly to changed expectations about the direction of overall economic policy and about monetary policy in the US. Monetary policy abroad will be of considerable significance for development going forward. A key issue for Sweden is how the krona develops during the autumn against the large global currencies. Particularly important will be the krona's development against the euro as a large proportion of Sweden's foreign trade is with the euro area, she pointed out.

In Sweden, the economy is continuing to develop strongly, with unexpectedly high outcomes for GDP growth and inflation. Resource utilisation will be higher than normal in the years immediately ahead. According to historical correlations, wages should therefore increase at a faster pace and inflation should become higher going forward. The normative wage agreements concluded earlier this year indicate, however, that wage increases will be fairly moderate in the years ahead, said Ms af Jochnick.

Ms af Jochnick also highlighted that the weak recovery in the euro area in recent years may have contributed to lower wages even in Sweden. Wages in the euro area affect the wage situation in Sweden's manufacturing industry, which is exposed to competition and which in turn is normative for Swedish wages. The Riksbank now expects the rate of wage increases to be moderate in the years ahead, and lower than what historical correlations with resource utilisation indicate. However, this is an uncertain forecast that raises important issues. She asked herself whether the labour market, not just in Sweden but also in several other countries, has been affected by globalisation, new technology and eCommerce in ways that have changed the relation between measures of domestic resource utilisation and inflation. She noted that this is an important area to continue to analyse and discuss.

The fact that the summer has seen strong growth and inflation figures is pleasing, she added, but this cannot be taken as a reason for claiming that the underlying inflationary pressure in Sweden is sufficiently strong. Inflationary pressure is rising slowly and the high inflation outcomes in June and July are positive but can be partly explained by temporary factors.

One important factor in Ms af Jochnick's monetary policy considerations is that inflation and inflation expectations should be stable around 2 per cent before monetary policy is tightened. Subdued wage increases suggest that domestic inflationary pressure is still rather moderate despite the strong GDP growth. Her assessment is therefore that monetary policy still needs to be expansionary until inflation stabilises permanently around 2 per cent.

Households' high indebtedness and the highly elevated housing prices are still creating vulnerabilities for the Swedish economy further ahead. Long-term, sustainable development in the Swedish economy presupposes a combination of measures in several policy areas, Ms af Jochnick pointed out.

Ms af Jochnick concluded by noting that monetary policy in recent years has been very expansionary and aimed at preserving the inflation target's important role as an anchor for price-setting and wage formation in Sweden. Monetary policy has made a significant contribution to the current strong development of the Swedish economy and inflation. An equally clear focus on realising objectives from other relevant policy areas would help to reduce the vulnerabilities for financial and macroeconomic stability.

Deputy Governor **Henry Ohlsson** began by supporting the proposal to hold the repo rate unchanged at –0.50 per cent. He further noted that the expansionary monetary policy conducted by the Riksbank has produced good results. All key macroeconomic variables indicate a very positive development for the Swedish economy in recent years.

The most recent inflation reading in July showed an annual rate of increase for the CPIF of no less than 2.4 per cent. The corresponding reading for July 2016 was 1.4 per cent. The recorded inflation rate was therefore above the inflation target in July. However, this reading is only for a single month. The August reading of five-year inflation expectations among money market participants was 2.1 per cent. Two-year expectations were 2.0 per cent in the same reading and one-year expectations were 1.8 per cent. According to Mr Ohlsson, inflation, both in terms of outcomes and expectations, needs to be more persistently close to the inflation target before it can be said that the target has been reached. But there is no doubt that Sweden is very close to the inflation target if we look at the trends in both inflation and inflation expectations.

Mr Ohlsson then went on to point out that the development for real macroeconomic quantities was also good. GDP growth is rapid. A weak outcome for GDP growth during the first quarter of 2017 had been published prior to the monetary policy decision in July. At that time, Mr Ohlsson pointed out that it was important to remember that the National Accounts are constantly revised and that preliminary outcomes change. The first preliminary estimate for GDP growth for the second quarter of 2017 is no less than 4.0 per cent compared with the same quarter last year. In Mr Ohlsson's view, his previous point that constant revisions are usually made is just as relevant for this preliminary outcome. It is important to be cautious when interpreting preliminary outcomes, both when they are lower and when they are higher than expected. According to the Monetary Policy Report, calendar-adjusted GDP is set to grow by 3.4 per cent in 2017. The forecast for 2018 is 2.8 per cent. These are high figures in a historical comparison, in his opinion.

According to the Labour Force Surveys, unemployment is currently on about the same level as before the financial crisis. At the same time, the number of job openings and job vacancies has doubled compared with the situation prior to the financial crisis according to statistics from both

Arbetsförmedlingen (Swedish Public Employment Service) and Statistics Sweden. This illustrates that the current matching problems on the labour market are much more significant than they were before the financial crisis. At the same time, the economic policy challenges that this poses are not only associated with the aggregated demand situation in the economy. Other policy areas have important tasks in order to improve matching on the labour market.

In Mr Ohlsson's view, it is pleasing that unemployment is showing a falling trend, although he still thinks that it is on too high a level.

Global trade in goods has accelerated in 2017 after slow growth in an historical perspective during 2016. For a small, open economy like Sweden – which is strongly dependent on developments abroad in general and in trade in particular – it is obviously very important.

Total resource utilisation in the Swedish economy has now passed normal levels. It can be expected to be even higher in the years ahead. Mr Ohlsson considered that this, in itself, is not necessarily a restriction for current monetary policy. In the prevailing economic situation, when inflation has still not stabilised close to the target, there is, in his view, no conflict of interest between real economic activity and inflation. What is there for the Riksbank to worry about in this situation, he asked himself rhetorically. That cost pressures are rising? That we are seeing signs of wage drift? That inflation will be higher? Yes, but higher inflation is exactly what the Riksbank is striving for until inflation has stabilised close to the target.

In other words, inflation is not yet stable close to the target. This is the crucial argument for an unchanged monetary policy just now, Mr Ohlsson concluded.

Governor **Stefan Ingves** opened by expressing his approval of the decision by the Executive Board at the day's meeting to adopt the CPIF as the target variable for monetary policy. In practice, the CPIF has long functioned as operational rudder and the formal switch of target variable will not affect Mr Ingves' assessment of the direction of monetary policy to reach the target. A variation band stretching between 1 and 3 per cent was also introduced to illustrate that each month's outcome does not have to be exactly 2 per cent. Developments in recent years illustrate this conclusion more than sufficiently. But the Riksbank is, of course, continuing to focus monetary policy on attaining the inflation target of 2 per cent.

The Riksbank's view of economic development has been fairly stable over the last six months. Not enough new information has been obtained yet to argue for a particularly different view. It is encouraging that the view of strong economic activity and rising inflation still stands. Abroad, the recovery is continuing, growth has broadened to include more countries and sectors, and world trade is growing.

Mr Ingves also observed that indicators in the US suggest a continued modest recovery, even if some signs of weakness have been noted. The dollar has weakened, which could be due to increased uncertainty over fiscal policy stimulation and changed expectations of the future monetary policy. In the euro area, recovery can be seen in more and more countries and political uncertainty has decreased. But even if prospects are slightly brighter, there are continued risks in the financial system that could create problems for the real economy. All in all, GDP growth in the countries that are most important for the Swedish economy (KIX-weighted) is expected to be about 2.5 per cent this year, after which it will slow down for a few years.

Global inflation rose at the end of 2016 and start of 2017 due to rising energy prices. Since then, the positive contribution from energy prices has decreased and held back inflation. In the period ahead, inflation is expected to be driven by rising resource utilisation, particularly in the US, which is far ahead in the economic cycle. In the euro area, in contrast, there is more spare capacity, which should hold back the rise in underlying inflation for a time. The stronger euro could also contribute towards delaying any increase in inflation. It is also noteworthy that core inflation abroad[3] has been lower than 2 per cent for several years. In light of this, Mr Ingves noted that it might not be so remarkable that the normalisation of monetary policy among the major central banks has taken time and is proceeding slowly. This cannot be avoided when reflecting over what would be an appropriate monetary policy for Sweden, he said.

There are thus low but rising inflationary pressures in the world around us. Overall, inflation abroad (KIX-weighted) is expected to rise from 1.1 per cent in 2016 to 1.9 per cent in 2017 and 2018 and to 2.2 per cent in 2019.

In Sweden, economic activity is strong and resource utilisation is higher than normal. GDP growth in the second quarter of this year was significantly higher than expected. Even if the strong GDP outcome is uncertain and may be revised, various indicators suggest a continued strong development for a few more years.

CPIF inflation in Sweden has shown a rising trend since 2014 and was higher than expected in June and July. The recent upturn in inflation is partly due to temporary effects. Among other things, this is a matter of temporary heavy price increases for foreign travel. This suggests that inflation will fall back slightly in the period ahead. Partly, however, there has also been a relatively broad rise in prices for services. Economic activity is stronger and, all in all, the forecast for the development of inflation has been revised slightly upwards. Conditions are good for inflation close to the inflation target over the forecast period.

But this assumes that Swedish monetary policy will continue to be expansionary, Mr Ingves pointed out. Increased productivity and restrained wage increases mean that domestic cost

[3] CPI/HICP adjusted for energy and food prices; KIX-weighted excluding China, India and Brazil.

pressures are still moderate despite stronger economic activity. The krona has also strengthened faster than the Riksbank expected in July. To this can be added the previously noted fact that core inflation abroad is still below 2 per cent, continued Mr Ingves. Cost pressures in the euro area, which play such an important role for the Swedish business sector, are still low; wage increases are modest, which also seems to be rubbing off on Sweden.

This does not mean that there are no upside risks for Swedish inflation, said Mr Ingves. But, in the event that inflation in the period ahead is higher than expected by the Riksbank, it will not be difficult to shift the focus of monetary policy and make it less expansionary. However, as he sees it, the Riksbank is nowhere near this situation today.

Mr Ingves went on to note that one central reason for maintaining the direction of Swedish monetary policy is that the normalisation of monetary policy abroad is continuing to move slowly. Compared with the forecast in July, there are now expectations of a somewhat more expansionary monetary policy abroad. The market's expectations of the future policy rate have fallen in both the US and the euro area. In this situation, it would be incautious and risky for the Riksbank to move ahead of the central banks in the major currency areas and start reducing monetary policy stimulus, he argued. This would contribute towards obvious risks for a heavy appreciation of the krona and lower inflation in Sweden. If the exchange rate strengthens and inflation is subdued, this would have to be compensated for by even higher domestic demand, increasing the risk of setbacks later on. Inflation has been below 2 per cent for six years and five-year inflation expectations have been below 2 per cent for three years. At the same time, an extraordinary monetary policy has been required to bring inflation back to target and turn inflation expectations around. In light of this, now is not the time to change monetary policy. Inflation and inflation expectations need a more permanent 'foothold' than they have at present, and, with the history we have behind us, a rate of inflation above target for a while would not be such a great problem, Mr Ingves stated.

GDP growth is expected to be just above 3 per cent in Sweden this year. However, at the same time, the real interest rate for bonds with long maturities is negative. One explanation for this is that the global long-term real interest rate has shown a falling trend in recent decades, among other reasons due to demographic factors. An ageing population and longer lifetimes have increased saving and pushed real interest rates down. The global real interest rate is also subdued due to low innovativeness and low GDP growth after the financial crisis. It will take time for global real interest rates to normalise. In a small, open economy, it is not possible to control this development, which also plays a part in interest rate setting in Sweden.

GDP growth in Sweden is expected to be relatively high over the forecast period. Mr Ingves deems that good growth and a negative long-term real interest rate in the Swedish economy can hardly coexist over the longer term. At some point, something will have to give. Either growth will continue to be good, resource utilisation will rise and the long-term real interest rate will eventually increase into positive figures. Or a more unpleasant scenario will await in the future, one we don't know so much about. The Riksbank's monetary policy is based on the first of these scenarios.

For example, an unfavourable scenario in Sweden could be triggered by some form of negative external shock and become serious as Sweden has an extreme degree of international dependence and major imbalances on the housing and property market. After a long period of rising housing prices and high indebtedness in the private sector, domestic imbalances are large.

Mr Ingves noted that, after a long period of low inflation, it is important that the Riksbank continues the work of safeguarding the inflation target's central role as anchor for price setting and wage formation in Sweden. Monetary policy therefore needs to be focused on contributing to inflation more permanently remaining around the target of 2 per cent. Small increases of the repo rate should have small effects on household indebtedness. A large increase in the repo rate could certainly slow down the build-up of debts but would also lead to unemployment increasing and the credibility of the inflation target being undermined. This is a trade-off that, at present, has no good, balanced solution, said Mr Ingves. The Riksbank lacks sector-specific instruments to manage financial imbalances in the household sector. Finansinspektionen's proposal for strengthened amortisation requirements from 1 January 2018 is a step in the right direction. However, further measures are needed in several areas to reduce the risks inherent in household indebtedness, increase household resilience and improve the Swedish housing market. If all loans to households and non-financial corporations in Sweden are analysed, it becomes clear that about 70 per cent of all loans have property as collateral.[4] This means that indebtedness is high in several parts of the Swedish economy: both households and property companies have large debts to the systemically-important banks, which have large amounts of loans with property as collateral on their balance sheets. To this can be added that the banks fund about half of their lending with wholesale funding, two-thirds of which is in foreign currency. If no further measures are adopted, there will be obvious risks for the stability of the Swedish economy further ahead, Mr Ingves pointed out.

The draft Monetary Policy Report notes that monetary policy is slowly normalising internationally, and that it is too early to adjust the direction of monetary policy in Sweden, Mr Ingves repeated. In light of this, he supported the proposal 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. Purchases of government bonds will continue during the second half of 2017, as decided in April, he concluded.

[4] Of all loans to households and non-financial corporations, 47 per cent consisted of mortgage loans to households, 5 per cent of other property loans to households, and 17 per cent of loans with property as collateral to non-financial corporations. Statistics Sweden, Financial market statistics, June 2017.

§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 B 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 interest rate decision under Sections 1 and 4 with the motivation and wording contained in a press release at 09.30 on Thursday 7 September 2017, and

• to publish the minutes of today's meeting on Thursday 21 September 2017 at 09.30.

This paragraph was verified immediately.

Minutes taken by

Sophie Brauner

Verified by:

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

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