SVERIGES RIKSBANK

Monetary policy minutes

July 2018

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

Summary

At the Monetary Policy Meeting on 2 July 2018, the Executive Board of the Riksbank decided to hold the repo rate at −0.50 per cent. The forecast for the repo rate is unchanged since April and indicates that slow repo rate rises will be initiated towards the end of the year.

A majority of the Executive Board supported the picture of the economic outlook and inflation prospects described in the draft Monetary Policy Report. Economic activity abroad is still favourable and in Sweden, activity is high, the labour market is strong and inflation is on target. It was noted that this picture is largely the same as in April and that the long-term forecasts are mainly unchanged.

At the same time, several members stressed that uncertainty surrounding developments abroad has risen since April, in part due to increased trade restrictions and the economic policy situation in Italy.

The fact that CPIF inflation is now close to 2 per cent and that the forecast for the year ahead has been revised up is mainly due to a rapid rise in energy prices. Measures of underlying inflation indicate that inflationary pressures are still moderate, which, according to several members, raises questions about the development of inflation in the long run. It was noted that a necessary condition for inflation to remain close to 2 per cent is for monetary policy to continue to be expansionary.

Against this backdrop, a majority of the Executive Board considered it appropriate to leave the repo rate and the repo rate forecast unchanged. As before, the forecast indicates that slow rate rises will be initiated towards the end of the year. At the same time, the majority emphasised that monetary policy needed to proceed cautiously with rate rises in this situation.

Several members discussed the volatile development of the exchange rate and the uncertainty the krona entails for inflation. The majority also advocated an extension of the mandate that facilitates rapid intervention on the foreign exchange market. A couple of members pointed out the structural problems on the Swedish housing market and the risks that these pose to economic development in Sweden.

Henry Ohlsson entered a reservation against the decision to hold the repo rate unchanged and against the repo rate path in the draft Monetary Policy Report. He recommended raising the repo rate to −0.25 per cent with reference to the strong economic developments in Sweden and abroad. Martin Flodén also entered a reservation against the repo rate path and advocated a rate path that indicated an initial rate rise of 0.25 percentage points in September or October of this year. Mr Ohlsson and Mr Flodén also entered reservations against the decision to extend the mandate for foreign exchange interventions.

MONETARY POLICY MINUTES

Executive Board, No 3

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DATE: 2 July 2018

TIME: 09.00

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

Michael Lundholm, Vice Chairperson of the General Council

Jan Alsterlind
Meredith Beechey Österholm
Charlotta Edler
Heidi Elmér
Robert Emanuelsson
Jesper Hansson
Maria Kindborg
Henrik Lundvall
Pernilla Meyersson
Ann-Leena Mikiver
Marianne Nessén
Amanda Nordström (§ 1-3A)
Bengt Petersson
Carl-Fredrik Pettersson (§ 1-3A)
Simon Rörborn
Maria Sjödin
Ulf Söderström
Anders Vredin

It was noted that Henrik Lundvall and Bengt Petersson would prepare draft minutes of the monetary policy meeting.

§1. Economic developments

Market developments since the last monetary policy meeting

Amanda Nordström from the Markets Department began by presenting the latest developments on the financial markets. Since the monetary policy meeting in April, bond yields have fallen in the euro area and the United States, coinciding with an escalation of global trade conflicts. The decrease in bond yields has been greatest in the euro area, where the European Central Bank (ECB) continues to conduct a very expansionary monetary policy. In the United States, where the monetary policy normalisation process has continued with another policy rate rise, yields fell by less. Intensified global trade conflicts have also had a negative impact on equity markets, not least in China. In addition, the economic policy uncertainty in Italy has periodically subdued equity markets in the euro area and led to higher bond yields in Italy. The euro has weakened considerably against the US dollar.

Prior to today's monetary policy decision, it is expected that the repo rate will be left unchanged, but opinions have diverged somewhat regarding future monetary policy. Expectations of the repo rate have shifted downwards slightly since April, as a majority of market participants do not now expect a first repo rate rise to happen until some point in 2019. Some market participants still expect a first repo rate rise from the Riksbank in December this year, but these now constitute a minority. The Swedish krona depreciated both against the euro and in competition-weighted terms immediately after the monetary policy meeting in April only to appreciate later on. In recent weeks, the krona has once again weakened, which can be linked to the impact on expectations of the Riksbank's monetary policy caused by the ECB's monetary policy announcement in June, which was perceived as more expansionary than expected by the market. The risks linked to greater protectionism have probably also contributed to a weaker krona exchange rate recently.

The current monetary policy drafting process – new data and forecasts

Jesper Hansson, Head of the Monetary Policy Department, began by presenting the forecast that the Monetary Policy Department judged would gain the support of a majority of the Executive Board. The monetary policy drafting process has included discussions with the Executive Board regarding the forecasts and the monetary policy assumptions at meetings on 14 and 19 June. The draft Monetary Policy Report was discussed and tabled at a meeting with the Executive Board on 26 June.

Three issues in particular have been discussed in detail during the drafting process. The first relates to the uncertainty surrounding economic developments abroad which, Mr Hansson pointed out, has increased since the monetary policy meeting in April. Important causes of this are the escalation of the conflict over trade restrictions between the United States and several other countries and regions, including the EU, and the increased economic policy uncertainty in Italy. Furthermore, the rising interest rates in the United States and the appreciation of the dollar exchange rate have created problems in several large emerging market economies that have deficits in their current accounts. The increased uncertainty regarding developments abroad have in turn led to a downward shift in market expectations of future policy rates in the euro area and in Sweden, Mr Hansson added. These changed market expectations, and the associated effects on the krona exchange rate, constitute the second issue afforded particular focus in the drafting process. The economic outlook in Sweden is largely unchanged compared with the assessment at the meeting in April and this is an argument in favour of an unchanged repo rate path. At the same time, elevated uncertainty about economic developments abroad usually leads to a weakening in the krona exchange rate. Overall, these circumstances make it particularly difficult at present to forecast the future krona exchange rate. The third issue relates to the correlation between resource utilisation and wage and price growth, the so-called Phillips curve. In recent years, this correlation seems to have weakened in some countries, including Sweden, at least as regards how resource utilisation affects wage growth.

Mr Hansson went on to discuss how new information received since the monetary policy meeting in April has affected the economic outlook and inflation prospects abroad and in Sweden. GDP growth abroad is slowing in line with the forecast from April while resource utilisation nevertheless continues to rise. Several measures of underlying inflation suggest moderate cost pressures, despite rising resource utilisation. In the proposal for a new forecast, trade-weighted inflation abroad is indeed higher in the year ahead, compared to the assessment in April, but this is largely explained by higher energy prices. As regards market expectations of future policy rates, these have risen slightly in the United States while they have fallen in the euro area. Therefore, the forecast for the weighted average of international policy rates has only been slightly revised.

In Sweden, economic activity remains strong and inflation is close to the target of 2 per cent. During the first quarter, GDP grew by just under 3 per cent, compared with the previous quarter and calculated as an annual rate. This was slightly more than in the Riksbank's last forecast. Many confidence indicators have fallen recently, but most of them are still on an above-normal level. In Mr Hansson's opinion, the lower confidence provides support for the assessment that growth will slow in the period ahead, as housing construction decreases and as growth on Sweden's export markets softens. In the new draft forecast, growth for this year and next year has been marginally revised downwards. At the same time, unemployment over the next quarter is expected to be slightly lower than in the previous forecast. Most indicators also point to strong labour demand in the period ahead, but a significant percentage of unemployed people lack the skills sought by employers and are therefore difficult to match to job vacancies. Unemployment is therefore not expected to fall further.

In May, CPIF inflation rose to 2.1 per cent, in line with the assessment in April. However, higher energy prices and an unexpected weakening of the krona exchange rate have led to the forecast for inflation during the year ahead being revised upwards. But in the longer term, inflation prospects are unchanged and the forecast is close to 2 per cent. This forecast is based on the assumption that cost pressures in Sweden will rise slowly in the years ahead. Wage growth is expected to increase gradually from 2.7 per cent this year to 3.4 per cent in 2020. The recent weakening of the krona exchange rate is deemed to be temporary and during the forecast period, a gradual strengthening of the exchange rate is expected, something which will subdue inflation in the longer term.

In conclusion, Mr Hansson emphasised that the draft forecast presented is based on the monetary policy that is expected to gain a majority at today's monetary policy meeting. This means that the repo rate is left unchanged at −0.50 per cent and that the repo rate path is the same as in the Monetary Policy Report from April. Slow increases of the repo rate will be initiated towards the end of the year. At the end of June, the Riksbank's government bond holdings amounted to about SEK 330 billion, expressed as a nominal amount. This forecast is based on redemptions and coupon payments being reinvested at an even pace going forward, in accordance with the decision in December last year, and on the mandate for foreign exchange interventions being extended to February 2019.

§2. The economic situation and monetary policy

First Deputy Governor Kerstin af Jochnick:

I support the assessments in the draft Monetary Policy Report, and I also support the proposal to hold the repo rate unchanged at −0.50 per cent and to leave the repo rate path unchanged. I also consider that the foreign exchange intervention mandate should be extended until February 2019.

Economic developments abroad are, generally speaking, good. Growth is high, although it is expected to slow slightly in the years ahead. At the same time, unemployment is very low in many countries; in the United States, for instance, it is at its lowest level in almost 20 years. Inflation is also close to central bank targets in many countries and regions, such as the United States and the euro area, although rising energy prices explain some of the recent upturn.

Overall, I do not think that our forecasts for international developments have noticeably changed compared with the assessment we made at the monetary policy meeting in April. In light of this, I will begin my contribution today by focusing on the uncertainty factors that can alter our forecasts for the global economy for the years ahead and thereby ultimately can also affect monetary policy in Sweden.

The draft Monetary Policy Report discusses two factors that are creating uncertainty about the strength of growth abroad over the next few years.

The first factor is the growing discussion on different forms of trade barriers between the United States and other countries and regions. I expressed concern about this at the last meeting, and developments thereafter confirm that more trade barriers are being introduced and discussed.

It is not currently possible to assess the actual effects of this, and neither is it something that has yet to be clearly reflected in growth figures. However, the ongoing discussion is contributing to the uncertainty about future developments and thereby risks leading to lower demand and growth later on.

The other factor causing concern is developments in Italy and the link to the rest of the euro area. If the new government proceeds with major unfunded reform proposals in a situation where the national debt is already very high, the question is how this will affect the monetary union and how the financial market’s view of Italy will be affected. As regards the financial markets in particular, we have already seen, for example, that the yield differential between Italy and Germany has increased substantially.

In addition to these two main factors, there are a few more uncertainty factors as regards growth abroad. One such factor is developments in certain emerging market economies. As before, there is also uncertainty surrounding the effects of Brexit, the United Kingdom's decision to leave the EU, which is difficult to assess but probably negative from a Swedish perspective.

Overall, there are hence a number of downside risks abroad that are difficult to assess and that we must consider in the monetary policy discussion. As Sweden is a small, open economy with considerable international dependence, poorer economic development abroad is something that could lead to the need to postpone an initial repo rate rise compared with the forecast for the repo rate.

As regards real economic developments in Sweden, it is worth mentioning that the forecast for both exports and imports has been revised down. Added to this is weaker domestic demand in the form of lower housing investment.

I will return to the housing market a little later. The forecast for Swedish GDP growth has not been revised down much, however, as a result of these changes. Overall, I therefore think that the picture of Swedish real economic development is similar to the assessment in April.

Neither has my assessment of the development of inflation in Sweden changed decisively since April. The main reason why inflation has been around 2 per cent in the last six months is rising energy prices and a weak krona. This is also the main reason why the forecast for CPIF inflation in the year ahead has been revised upwards.

In my opinion, it is reasonable for us to try to see through temporary effects from energy prices in our monetary policy deliberations in order to focus on the level of trend inflation instead. As we present in the report, it is also important for our analysis that we measure inflation in different ways. Adjusted for energy price rises, underlying inflation – measured in terms of the CPIF excluding energy – is about 1.5 per cent, which suggests moderate inflationary pressures.

This is confirmed not least by the fact that prices for services have developed more weakly than previously in recent months. If the weak growth in prices for services continues, there is a risk of inflation not stabilising around 2 per cent as we forecast. It continues therefore to be important that monetary policy provides support to the Swedish economy so that inflation can gain a broader foothold.

My assessment is that there is still good reason to believe that the rate of increase in prices for services will rise in the period ahead. Prices for services are more dependent than goods prices on domestic factors such as wage development and demand.

A great deal now indicates some upward pressure on wages in Sweden, further facilitated by signs of rising wage growth abroad. Low unemployment and high labour shortages both in the business sector and the public sector also mean there is reason to believe that Swedish companies will let cost increases feed through to prices and that the rate of increase in prices for services will thereby rise.

I discussed earlier the risks associated with developments abroad. As regards risks in Sweden, the housing market and household indebtedness continue to be a source of considerable unease, and broad political agreement within the framework of housing and taxation policy would be desirable in order to mitigate these risks.

In my view, the slowdown in housing price growth since the autumn is a positive development. It appears largely to have taken place in metropolitan regions and is primarily related to tenant-owned apartments. The reason for the price downturn is probably the fact that the demand for expensive new homes in attractive areas is saturated. It is important to guarantee a continued high level of new construction, however, in order to meet the housing needs of a growing population, something which not least Boverket, the Swedish National Board of Housing, Building and Planning, discusses in its most recent report. Finding a reasonable, long-term balance between tenant-owned housing and rented accommodation and increasing mobility on the housing market would reduce vulnerability in the Swedish economy and promote good societal development.

Deputy Governor Martin Flodén:

At our last monetary policy meeting in April, I said that I would have preferred to see a forecast for the repo rate that clearly indicates that there is a possibility of the repo rate being raised in the early autumn. I also said that a development that may provide an argument for an early rate rise is if the krona does not strengthen as quickly as in our forecast, especially if the weak exchange rate also starts to feed through to inflation figures.

Developments since the last monetary policy meeting have been quite eventful. For example, the krona has not appreciated as in our forecast. The krona has periodically been very weak and on average was almost two per cent weaker during the second quarter compared with our forecast in April. The forecast for the third quarter is now 3.5 per cent weaker than at the meeting in April. The weak exchange rate is starting to have an impact on import and producer prices but has yet to have any clear effects on inflation. Underlying inflation continues to show signs of weakness, but CPIF inflation has been surprisingly high due to rapidly rising energy prices.

Other important developments concern economic activity in Sweden and abroad. There are clearer signs of economic activity in Sweden and the economic upturn abroad starting to slow. In Sweden, construction and confidence indicators have tailed off. In the euro area, too, confidence indicators have softened. In addition, there is concern over increased trade barriers and over developments in Italy.

What all this means for Swedish monetary policy is not entirely obvious and I will return shortly to my reasoning. To sum up, I take the view that it is appropriate today to leave the repo rate unchanged at −0.50 per cent but that it is appropriate to signal and plan for a monetary policy where the repo rate is raised slightly earlier than is proposed in the draft Monetary Policy Report. More precisely, I advocate a rate path that indicates an initial rate rise by 0.25 percentage points in September or October this year, a second increase about one meeting earlier than is projected in the draft report, and that then coincides with the draft report’s rate path from the third quarter of next year onwards.

The repo rate path I advocate is indeed similar to the one in the draft report, but as I take the view that it is important for us to prepare the markets in good time that rate rises may be justified in September or October, I am unable to support the proposal in the draft report. I have entered reservations against the previous decisions regarding the mandate for foreign exchange interventions, and my objections to these decisions still stand. I therefore do not support today’s proposal to renew the mandate.

I shall now discuss the reasoning behind my stance.

Based on how the exchange rate has developed after the April meeting, the arguments for an early rate rise have been strengthened. As I said, the krona has been periodically very weak and in our forecast, the krona is now significantly weaker compared with the assessment in April. The weak exchange rate will help to keep inflation up in the year ahead.

The weakening of the krona after the April meeting indicates that our monetary policy signals were perceived as more expansionary than we intended. This is also reflected by the fact that market-priced expectations of the repo rate have shifted downwards, that they are below our repo rate forecast and that few market participants now believe that the rate will be raised before our meeting in December. This is the case even though our forecast for the repo rate can only be interpreted as there being a high probability of the rate being raised at the meeting in October.

The development of inflation has been mixed. CPIF inflation has been a little higher than expected as a result of surprisingly rapid increases in energy prices. Underlying inflation has instead developed surprisingly weakly. This weak underlying inflation continues to be a cause for concern that raises question-marks about the development of inflation in the long term. In the near term, however, the risk of a problematic development of inflation and receding inflation expectations has decreased as a result of both the upturn in energy prices and the weak krona. The forecast for CPIF inflation has been revised up quite significantly for the year ahead and is above the target.

My assessment is therefore that a slightly tighter monetary policy in the near term than the one proposed in the draft Monetary Policy Report, and thereby slightly lower inflation in the year ahead, would not be particularly problematic. Indeed, my view is that such a policy is also appropriate, although there are factors that provide arguments both for and against.

Let me first point out that my assessment is not based on a concern that inflation would otherwise be too high. There is nothing to suggest that inflationary pressures risk becoming problematically high. And it is of course not a problem if inflation is temporarily a few tenths of a percentage point over 2 per cent, especially after many years of excessively low inflation and low inflation expectations.

A factor that, on the other hand, provides an argument for an early initial rate rise is that monetary policy with negative interest rates is, and is perceived to be, unconventional. Monetary policy in recent years has indeed worked well and had limited negative side-effects, but I think it is positive to start moving towards a slightly more normal monetary policy as soon as it can be done without damaging confidence in the inflation target.

A related factor is that interest rates have now, for a long time, been on a significantly lower level than we assess to be normal in the long term. Our forecast for the timing of the first repo rate rise has been repeatedly postponed and increasingly often I hear speculations that the Riksbank will continue to shift this forecast forward. Monetary policy will be more effective if the expectations of households and the market do not deviate too far from the Riksbank's planned monetary policy. A rate rise in the autumn, and signals of such a rise today, would probably prevent a development whereby expectations become far too expansionary. A risk associated with an early rate rise is that expectations instead shift rapidly in the other direction, but such a scenario can most likely be avoided if we are clear about the continued need for a very expansionary monetary policy and that we still see before us a slow normalisation of the interest rate.

Another factor that I have considered in my assessment is the combination of an abnormally weak exchange rate and inflation that is temporarily being held up by high energy prices. A slightly tighter monetary policy in the near term would probably lead to the krona appreciating earlier than in the forecast in the draft report. This would lead to slightly lower inflation in the short term, i.e. approximately during the period in which energy prices will have the opposite effect. The krona would then not need to appreciate as rapidly thereafter, and hence would not hold inflation back as much a few years ahead.

There are also a number of factors providing arguments against a tighter monetary policy. One is that inflationary pressures are still low both in Sweden and abroad. As I have already pointed out, inflation is currently still being held up by rising energy prices. But in the slightly longer term, the problems of weak inflationary pressures will remain. I do not therefore envision a monetary policy towards the end of next year that is tighter than in the draft Monetary Policy Report.

Another factor is the long history of below-target inflation and weakened confidence in the inflation targeting policy. Against this backdrop, it would be more difficult to manage inflation that falls below the two-percent target than inflation that is too high. But confidence in the inflation target has nevertheless strengthened in recent years as inflation has risen and has now been close to target for over a year. These problems remain, but are carrying less and less weight in my assessment.

A third factor that could provide an argument against a tighter monetary policy is the signs of a slowdown in economic activity. But I don’t see this as an obstacle to rate rises in the autumn. It is not growth and employment, but rather the low inflation that has required the support of a very expansionary monetary policy. Even with a certain slowdown in economic activity, resource utilisation in Sweden will be high. And the monetary policy I am advocating is still more expansionary than is justified by economic activity.

Continued weak inflation in combination with the increased concern regarding developments abroad have led to a downward shift in policy rate expectations in, for example, the euro area. The ECB is now expected to start raising the interest rate in the autumn of 2019 at the earliest. Monetary policy abroad spills over to developments in Sweden in different ways. With slower international rate rises, it may also be appropriate with slower rate rises in Sweden. However, this mostly relates to developments from next summer onwards. This is another reason why I am not advocating a tighter monetary policy from the end of 2019 than in the draft Monetary Policy Report.

I support the picture of the economic outlook and inflation prospects described in the draft Monetary Policy Report. I also support the decision to leave the repo rate unchanged at −0.50 per cent. However, I do not support the proposed repo rate path. I advocate a rate path that indicates an initial rate rise by 0.25 percentage points in September or October this year, a second increase about one meeting earlier than in the proposed rate path, and that then coincides with the draft report’s rate path from the third quarter of next year onwards. Neither do I support the proposal to renew the mandate facilitating foreign exchange interventions.

Deputy Governor Per Jansson:

Since the monetary policy meeting in April, two new outcomes for inflation and inflation expectations have been published. The most recent inflation outcome, for May, reported a CPIF inflation rate of just under 2.1 per cent. This was a good tenth of a percentage point higher than the forecast in the April Monetary Policy Report. Adjusted for energy prices, the outcome was just under 1.5 per cent. And this in turn was almost a tenth of a percentage point worse than expected. The forecast errors are thus small and outcomes are close to the assessment we made in April.

That said, there are still questions regarding the strength of the more underlying inflation rate. Although the most recent forecast error for CPIF inflation excluding energy was small, the outcome once again turned out to be lower than expected. It is clearly worrying that we have overestimated this measure of underlying inflation for four months out of five this year. But it is perhaps even more worrying that the weakening trend in prices for services is continuing.

I noted at the monetary policy meeting in April that, after continuously declining price growth for seven months in a row, there had been some upturn in the rate of increase of service prices in March compared with February. However, this upturn appears to have been very temporary, unfortunately. The rate of price increase declined again in both April and May, and most recently in May was a low 1.7 per cent. It cannot of course be ruled out that the weak development in service prices is due to certain temporary factors, but we have now to go back to the beginning of 2017 to find a similarly low rate of price increase.

The fact that CPIF inflation excluding energy prices remained relatively close to our forecast in May, despite the worryingly poor development in service prices, and also rose slightly compared with April, is due to unexpectedly large increases in prices of fruit and vegetables, probably mainly caused by the weaker krona exchange rate. As it will not be possible over time to counteract a low rate of increase in service prices with a weaker currency, the conclusion I drew at the monetary policy meetings in February and April still stands, namely that the present rate of increase in service prices is not sufficiently strong for the Riksbank to be able to stabilise inflation close to the target going forward.

As discussed and illustrated in the draft Monetary Policy Report, it is not only CPIF inflation excluding energy prices that currently indicates that underlying inflation is showing signs of weakness and is low.[1] The Riksbank regularly calculates a large number of measures of underlying inflation, which all indicate that trend inflation fell last autumn or at the beginning of this year. In May, the mean value of the different measures was just under 1.5 per cent, that is, entirely in line with the listing for CPIF inflation excluding energy prices.[2] Neither CPIF inflation excluding energy prices nor any other measure of underlying inflation is a target variable for monetary policy. But this type of measure of trend developments in inflation often provides a good indication of where inflation is heading in the longer run. The fact that these measures have now taken a downward turn and are well below 2 per cent points to there being a risk of CPIF inflation not necessarily remaining close to the inflation target going forward.

[1] See the box "The inflation target and measures of underlying inflation" and Figure 3:3 in the draft Monetary Policy Report.

[2] CPIF inflation excluding energy prices has been excluded from the mean value calculation.

When it comes to inflation expectations, as measured by Prospera's monthly and quarterly surveys, a generally bright picture is painted, with expectations reasonably close to the inflation target for all types of respondents and time horizons. The changes in the two new surveys for May and June are generally small. If anything, the impression is that the dispersion of responses around the inflation target has declined somewhat. According to the quarterly survey for March, the mean value for seven out of a total of 30 response categories, or just over 23 per cent, was outside the interval of 1.8-2.2 per cent.[3] In the most recent survey in June, only the mean value for two out of 30 response categories, or almost seven per cent, was outside of this interval.

I expressed some concern at the monetary policy meeting in April about the downturns in inflation expectations among labour market organisations revealed in the March survey. In that survey, the CPI inflation expectations of employer organisations fell by around 0.2 percentage points both one and two years ahead. As regards employee organisations, it was instead their expectations of CPIF inflation that fell quite significantly, by just under 0.2 percentage points two years ahead and just over 0.3 percentage points five years ahead.

Fortunately, the June survey showed clear upward adjustments for all of these figures. This is, of course, welcome. But going forward it would also be desirable if the fluctuations in expectations among labour market organisations were dampened somewhat. The fact that these inflation expectations show such substantial fluctuations between surveys is worrying, bearing in mind how important it is that the labour market organisations in particular perceive the inflation target as a stable anchor for price-setting and wage formation.

The conclusion I draw from the developments in inflation and inflation expectations is that the current inflation picture is about the same as in April. CPIF inflation remains close to our forecast and the target, but this depends to a high degree on large contributions from rising energy prices. The more underlying inflation rate, which often gives a good indication of where inflation is heading in the longer run, is continuing to show signs of weakness and to be low. A very important condition for inflation to remain close to 2 per cent going forward is that service prices show stronger developments and begin to contribute more to the price increases. Inflation expectations are close to the target and also appear to be showing slightly greater stability. What now remains is for this also to be reflected in a somewhat more convincing way in price-setting and wage formation.

If we look at the proposed forecast in the draft Monetary Policy Report, a relatively large upward revision has been made to the assessment of CPIF inflation in the coming year. The revision is largest for a few months around the end of 2018 and the beginning of 2019, when the inflation forecast is around 0.5 percentage points higher than in the April Monetary Policy Report. The forecast entails a peak for inflation in January 2019, when it is calculated to be as high as 2.5 per cent. However, it is important to note that this upward revision to the forecast is not the result of improved demand or wage conditions, but is due to energy prices continuing to surprise on the upside, while the krona

[3] In the survey, five different types of respondents (employee organisations, employer organisations, purchasing managers in the manufacturing industry and retail trade, and money market participants) are asked about their expectations of inflation for one, two and five years ahead. The questions refer to both CPI and CPIF inflation. Each respondent thus replies to six different questions. With five different types of respondents, the responses can therefore be divided into 30 different response categories. The calculation here refers to the mean value of responses for each of these 30 categories.

exchange rate has also once again developed more weakly than expected. Of course, the new forecast assumption for the development of the krona also affects the assessment of CPIF inflation excluding energy prices, but here the effects are fairly small, normally no greater than around one tenth of a percentage point. The proposed forecast adjustments mean that CPIF inflation will overshoot the inflation target until summer next year, and will thereafter be largely in line with the target. Excluding energy prices, however, inflation will already be close to 2 per cent from the turn of the year.

I support the forecasts in the draft Monetary Policy Report. And I also support the monetary policy proposed therein. But just as at our meetings in February and April I still believe, in relation to the repo rate path on which our forecasts are now based, that the probability of needing to postpone the first rate increase is greater than the probability of it being possible to bring it forward. In a strict sense, this means that my own forecast for the repo rate is lower than the forecast I am now giving my support to. That I nevertheless feel that I can support the monetary policy assumption in the draft report has to do with the fact that the difference from my own forecast is not particularly great. In addition, we are talking about forecasts that are of course uncertain and there is further time to adjust them before the time comes to actually implement the first rate increase.

The fact that my own forecast for the repo rate is only slightly lower than the forecast in the draft report does not mean, however, that this is an unimportant question, in my view. It is not possible to rule out that the effects on inflation, and in the worst case also on the economy as a whole, may be fairly significant even if the Riksbank only makes minor adjustments to the timing of the first rate increase. This in turn is connected to the possibility of the prevailing monetary conditions, and particularly the level of the krona exchange rate, being affected by market expectations of how the Riksbank may act in the quite distant future. If a relatively early rate increase were then to mean that the market reconsidered its view of the Riksbank's future monetary policy in a more radical manner, then the result could be a rapid and tangible tightening of Sweden's monetary conditions. This would of course have negative effects on inflation and if the tightening is sufficiently sizeable could also create fairly serious problems for the real economy by affecting output and employment.

It is possible that the probability of such a scenario is not particularly great. But if it were to occur, the consequences could be very difficult to manage. It is therefore important to conduct monetary policy in such a way that the risk of this scenario occurring really is very small. It is of course important to note in this context that there are already some question marks regarding the strength of inflationary pressures, even without this type of complication. In addition, the fact that the market is now expecting the ECB to raise its policy rate somewhat later and at a slower pace than before, at the same time as there are several serious risks in the international economy, does not of course make it less important in this situation to avoid a severe tightening of the monetary conditions.

I have so far chosen to refrain from quantifying how much lower my own forecast for the repo rate is compared with the Riksbank's forecast. But if I now force myself to do so, my starting point is that at present the probability of it being possible to implement the first rate increase at the end of this year is approximately the same as it occurring in the spring of next year. Translated into differences in basis points, this means that my own repo rate path during the period in question is on average around ten basis point lower than the Riksbank's forecast. This rough estimate must of course be taken with a pinch of salt, but it nevertheless confirms that the difference between the forecasts is minor. Formulated in words, one can say that even with my own repo rate path, it is fully possible for the first rate increase to take place at the end of this year, but that we should also be open to the possibility that it may be delayed until sometime into next year.

Deputy Governor Cecilia Skingsley:

I support the assessments, forecasts and draft monetary policy decision in the Monetary Policy Report.

Since April, economic activity abroad has continued to develop favourably and in line with the previous forecast, but the risks of poorer international developments that affect Sweden have also increased. I would like to mention three things.

Starting in Europe, the Italian stock market has fallen and bond yields have risen due to concerns about the new government's economic programme and approach to EU cooperation. Market rates have since stabilised somewhat, but the turbulence in May, which also had certain spillover effects in neighbouring countries, is a reminder that there are structural vulnerabilities in the Italian economy. In contrast to during the European debt crisis of 2010–2012, the EU has strengthened its institutional capacity to manage problems but the new institutions must nevertheless be described as relatively untested. The forecast revisions in the draft Monetary Policy Report relate to the Italian economy and are assumed to have minor spillover risks to other countries. In combination with other international difficulties, however, the problems in Italy may become a larger problem for the euro area, and hence for Sweden's most important trading partner.

As regards foreign trade, the risks of poorer development have also increased. The initiative by the United States regarding changed trading terms and the subsequent international response may have greater effects on economic activity via financial markets and weakened trust in the future. The macro-effects are so far deemed to be small, but this is on the basis of information received up to now. A more permanent retreat from international integration that has been deepening for decades would lead to weaker development in Sweden as well.

A third circumstance that is increasing the risk of poorer global development is that financial conditions have started to tighten, driven by interest rate hikes from the Federal Reserve. This has led to spillover effects on emerging economies that are exposed to dollar funding and have weak current accounts and/or weak public finances. The tighter financial conditions are also noticeable in that previously large capital inflows to a number of emerging economies have decreased. Tighter financial conditions driven by monetary policy are a natural event given that the US economy has come a long way in its economic expansion, but the risk is that the tightening does not occur gradually, leading to both financial and cyclical difficulties for dollar-dependent countries.

These three international circumstances, particularly the risk of greater protectionism, are not easily captured in forecasting models. But they constitute downside risks for the economic assessment.

However, economic development in Sweden remains strong. With historically high resource utilisation after several years of expansion, growth is expected to slow to historically more normal levels in the period ahead. The slowdown in growth does not hinder the scope for normalising monetary policy, however, as resource utilisation is expected to remain high.

Since the April meeting, two new inflation outcomes have been presented. Target achievement, i.e. keeping CPIF inflation close to 2 per cent, is currently good. But in order to assess the conditions for keeping inflation close to target, different measures of underlying inflation need to be considered.

Driven by the continued economic expansion and previous weakening of the krona, the forecast for the CPIF excluding energy has been revised up slightly compared to the assessment in April. The absence of negative surprises in inflation also creates greater stability in inflation expectations, enabling the Riksbank to start rate rises in accordance with the previous forecast.

The exchange rate is one of several important factors when analysing inflation and assessing appropriate monetary policy. The unexpected depreciation of the krona during the spring has led to some criticism of the Riksbank's monetary policy, along the lines that the weakening is driven by the bank's reluctance to raise interest rates.

This criticism warrants two comments: The first is that the krona is not the only currency that has weakened. Similar trends can be noted also for several other smaller economies with significant foreign trade.

My second comment is that the fixed-income market, expressed in forward prices, has made a significant shift in its expectations regarding the Riksbank. Just less than a year ago, forward prices indicated an expectation of a rising repo rate at the beginning of this year.

The market believed then that rate rises would start before the Executive Board itself thought they would. The fixed-income market then changed its expectations and according to current pricing is not expecting the first interest rate increase by the Riksbank until 2019. During the same period, the Executive Board's forecast has shifted much less. At our last meeting in April, the forecast for the timing of the first rate rise was shifted slightly from the second half of 2018 to the end of 2018.

The changed expectations from the fixed-income market has contributed to the krona depreciation, in contrast to the Executive Board's forecast for a stronger krona. The reasons for the fixed-income market's changed expectations regarding the Riksbank's policy are for me rather unclear, as the Executive Board's forecasts and monetary policy plan have been only marginally adjusted during the period I am discussing. Instead, it may be international events that have made the fixed-income market shift its expectations of Swedish monetary policy, but the blame for these circumstances can hardly be laid at the door of the Riksbank.

So what does this mean for the krona forecast going forward? The fact that the Executive Board is sticking to the same repo rate path as in April could strengthening the krona after today's interest rate decision but it is just as likely that the krona will not appreciate, due in part to the international risks I mentioned in my introduction probably being of a rather long-term nature. As far as Sweden is concerned, we also have opinion polls signalling uncertainty regarding the formation of a new Swedish government, which could burden the krona for a while longer.

In this context, I would also like to say a few words about the decision to extend the mandate for foreign exchange interventions as a possible complementary monetary policy measure. It is perfectly possible to make interventions even without such a mandate, but I see it as prudent to delegate a responsibility to enable rapid action should it become necessary. The mandate could be questioned based on the unexpected krona depreciation in recent months making it unlikely that the Executive Board would wish to intervene. But it is not the current level that is the most important factor to consider but rather the plausible consequences of the krona starting to appreciate unexpectedly sharply.

In conclusion, I would like to say a few words about the repo rate path.

I have previously said that as it has taken longer than expected and required significant monetary policy expansion to return inflation to target, it is important to proceed cautiously when it comes to rate rises.

The upwardly revised CPIF forecast might be an argument for bringing forward rate rises, including one in September, but in my opinion the received data does not deviate enough from the forecasts nor are the forecast revisions large enough to warrant taking such a step.

Since April, however, the economic statistics have strengthened my view that an unchanged forecast for the repo rate going forward represents the best forecast. An initial rate rise at the end of this year would mean that by that time inflation will have been close to target for almost 18 months, which has been necessary given the previous difficulties in reaching the target.

In April, I said that, assuming the present assessment of economic development holds true, I consider it likely that I will support a rate rise at one of the meetings in October or December. That assessment also applies at this meeting.

Deputy Governor Henry Ohlsson:

To begin with, I would like to say that I do not support the proposal to hold the repo rate unchanged at −0.50 per cent. It is my opinion that the repo rate should be increased by 0.25 percentage points to −0.25 per cent. As a consequence of this, I also am of the opinion that the interest rate path should be brought forward so that it is consistent with my proposed repo rate increase. Nor do I support the proposal to extend the mandate to intervene on the foreign exchange market.

The economic situation abroad is good. One expression of this is that global trade in goods is increasing. Over the past 12 months, the annual rate of increase has stood at just over 4.5 per cent. Increased trade is of crucial importance for a small, open economy like Sweden's. The dawning protectionism therefore gives cause for concern. At the same time, it remains to be seen what consequences new tariffs and threats of new trade barriers will have on world trade.

Annual growth abroad, KIX-weighted, is expected to amount to 2.7 per cent in 2018 according to the draft Monetary Policy Report. For 2019, the forecast is 2.4 per cent. KIX-weighted inflation has been revised up and is assessed to be 2.2 per cent in 2018 and 2.1 per cent in 2019.

The good global macroeconomic conditions mean that as regards international developments, there are expectations of a less expansionary monetary policy. The Federal Reserve has increased its policy rate several times. According to the draft Monetary Policy Report, the weighted average of international policy rates is expected to rise, albeit at a slow pace. One important example of developments in global interest rates is that the yield on ten-year US government bonds has recently varied around 3 per cent. This is a level that has not been seen since the end of 2013/beginning of 2014.

Let me now move on to Sweden. Since the autumn, the target variable for monetary policy has been the CPIF. The annual rate of increase of the CPIF was 2.1 per cent in the most recent inflation reading in May. CPIF inflation has been around the inflation target for a long time. In the last 14 months, CPIF inflation has been in the interval 1.7 – 2.4 per cent. The average rate of inflation over these 14 months has been 2.0 per cent. According to the forecast in the draft Monetary Policy Report, inflation will be 2.1 per cent as an annual rate in both 2018 and 2019. These are substantial upward revisions in relation to the assessment in the April Monetary Policy Report. Target attainment is good!

The June reading of five-year inflation expectations among money market participants was 2.0 per cent. Over the last 30 months, the mean value of five-year expectations has been 1.9 per cent or higher. The impression that inflation expectations are at the two-percent target is strengthened if we look at expectations two years ahead. In June, these expectations were also at 2.0 per cent. Looking back, two-year expectations have been 1.9 per cent or higher for the last 18 months. For the tenth month in a row, expectations for one year ahead were at 1.9 per cent or higher. This is the first time this has happened for ten months in a row, since February-November 2011. Inflation expectations are now well anchored!

I will now move on to a discussion of the situation on the labour market. Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. In May 2018, the percentage of openly unemployed fund members was 2.4 per cent. This is actually higher than the same month in the previous year. Then, the percentage of unemployed fund members was 2.2 per cent. A few tenths of one per cent here or there makes no great difference, but qualitatively, it is interesting that the downward trend that we have seen for several years has now been broken. The break in the trend emphasises that unemployment has now bottomed out.

This is also suggested by the outcomes for unemployment as measured by Arbetsförmedlingen (Af), the Swedish public employment service. The sum of registered, openly unemployed and those on labour market programmes as a proportion of the register-based labour force was 6.8 per cent in May 2018. This can be compared to 7.3 per cent in the same month last year. But what is really interesting about Af's statistics is the comparison that can be made between the development for those born in Sweden and those born abroad. For those born in Sweden, unemployment in May was 3.5 per cent, according to Af's statistics. The same month one year ago, the figure was 3.8 per cent. This is certainly a decrease, but not a large one. For those born abroad, the corresponding unemployment figure was 20.2 per cent in May 2018 and 21.9 per cent in May 2017. My interpretation is that the decrease in unemployment according to Af above all reflects a decrease for those born abroad. For those born in Sweden, on the other hand, this reinforces the image of unemployment having bottomed out.

But the official measure of unemployment in Sweden is given by the Labour Force Surveys (LFS). At the same time, I think it is important to have the other two measures as a background when interpreting the LFS. According to the most recent labour force survey (LFS), unemployment was 6.5 per cent (not seasonally adjusted) in May. This is lower than the corresponding month one year earlier, when LFS unemployment was 7.2 per cent.

In my opinion, however, unemployment is still too high. But today it is rather a matter of bringing down unemployment among those born abroad. And here it is, above all, a matter of labour market programmes that strengthen the human capital of the unemployed and cut the costs of employing them, rather than general demand policy.

Against the backdrop of this reasoning, I would now like to move on to my monetary policy considerations. Inflation has now been around the target of 2 per cent in outcomes and expectations for a long time. This is the decisive argument indicating that it is now time to start normalising monetary policy. Occasional monthly variations of the odd tenth of a percentage point around the 2 per cent mark cannot be allowed to determine monetary policy. But instead, monetary policy has become more expansionary since the April decision, if one looks at the real repo rate according to the draft Monetary Policy Report (see Figure 1:8).

The price stability target for monetary policy essentially concerns households' living costs not increasing too rapidly. This is why the consumer price index is used to measure inflation. In Sweden, it is the CPI that is the measure of living costs and the target for monetary policy is worded in terms of the CPI with a fixed interest rate, the CPIF. It is of course interesting to study different breakdowns of the CPIF. They could, for instance, concern the difference between goods and services. It could also be a case of comparing prices that develop as a result of a permanently ongoing development with prices that result from temporary changes.

But it is important that such analyses do not eclipse the target for monetary policy. The introduction of the variation band was also based on the fact that there are always unexpected events, white noise and uncertainty, making it not always possible to exactly attain the inflation target. If one chooses to discount certain prices, one risks excluding relative price changes. Since the end of 2015, energy prices have shown an increasing trend that is faster than other prices in the CPIF. Of course, it can be interesting to study the CPIF excluding energy prices. But households in Sweden cannot disregard energy prices, not when they are standing at the petrol station filling up their cars and not when paying their electricity bills via their on-line banks. Energy costs are part of living costs. Overall, these monetary policy considerations mean that I cannot support the picture of the economic outlook and inflation prospects in the draft Monetary Policy Report.

Finally, the decision on a mandate for the Riksbank Governor and First Deputy Governor to intervene on the foreign exchange market was made in a situation where inflation and inflation expectations were way below the target. The current situation is different. With inflation and inflation expectations close to target, I consider that issues related to possible interventions on the foreign exchange market can be managed without a special mandate.

In conclusion, it is my opinion that the repo rate should be increased by 0.25 percentage points to −0.25 per cent. As a consequence of this, I also am of the opinion that the interest rate path should be brought forward (but with the same slope as in the draft Monetary Policy Report) so that it is consistent with my proposed repo rate increase. Nor do I support the proposal to extend the mandate to intervene on the foreign exchange market.

Governor Stefan Ingves:

I would like to start by saying that I share the view of economic developments abroad and in Sweden as described in the draft Monetary Policy Report. Compared with the forecasts made in connection with the monetary policy meeting in April, there are only minor revisions to the longer-term forecasts in today's draft and it therefore is natural for me to support the proposal to keep the repo rate at its current level of −0.50 per cent, and for an unchanged repo rate path. I also support the proposal to extend the mandate to facilitate rapid interventions on the foreign exchange market, if they prove necessary to safeguard the inflation target. As part of the monetary policy, reinvestments of redemptions and coupon payments in the government bond portfolio will continue in accordance with the plan adopted in December 2017. During the first half of the year, purchases have amounted to just under SEK 1 billion a week and they have worked well. In addition to normal rate-setting, the reinvestments allow us to maintain our preparedness in monetary policy to act in an unorthodox manner, something which I deem to be valuable for a while yet.

If we look at developments abroad, we can see that global growth is still good. Growth abroad is this year expected to be a good 2.5 per cent (measured in KIX-weighted terms), with good growth figures continuing in the years thereafter. But there are new and old sources of concern that we need to monitor closely. In Europe, for example, there are question marks regarding the long-term sustainability of government finances in Italy if the country's fiscal policy is changed in a more expansionary direction. In the global economy, unease is growing regarding the potential effects of the escalated trade conflict between the United States and its major trading partners. And several emerging market economies are grappling with economic problems. There is reason to believe that these tensions will increase as interest rates rise in the United States. These kinds of trade and geopolitical risks are difficult to assess and cannot be easily quantified. They are therefore not necessarily visible in the forecasts, but may nevertheless affect policy later on depending on developments. If they occurred, they would be downside risks for an open economy like Sweden's. Global growth is good, but international risks have increased.

Economic developments in Sweden remain good. Growth this year is expected to be 2.5 per cent, slightly above the historical average and marginally lower than the forecast in April. Exports have been revised down by almost two percentage points compared with the assessment in April, due in part to a weaker-than-expected outcome for the first quarter of this year and signs of weaker transmission between global growth and trade. But imports have been revised down for the same reasons and the change in the forecast for net exports, and the effect on GDP, is therefore minor, although still a cause for concern. The situation in the labour market continues to be very strong. Labour force participation and employment rates have reached historically high levels. Unemployment, which has fallen by almost two percentage points since 2014, is deemed to have bottomed out and is expected to rise slightly in the years ahead, despite high shortages, which stem from various matching problems. Resource utilisation, both on the labour market and in the economy as a whole, is expected to rise this year and be higher than normal in the years ahead. Despite this, however, inflationary pressures are limited. In this respect, old correlations seem not to fully apply.

The rate of inflation has developed in line with our target of two per cent for a while. Our task now is to ensure that inflation continues to develop in line with the target. As is shown in the draft Monetary Policy Report, various measures of underlying inflation have shown weak development. These measures are constructed slightly differently but in common they all try to remove the white noise from inflation statistics so that more permanent inflationary pressures emerge. Figure 3:3 in the report summarise ten or so such measures of underlying inflation in the form of a range. It is clear from the figure that the various measures of underlying inflation showed a rising trend from 2014 until last year. The upturn was then interrupted and now the various measures indicate that inflationary pressures are moderate. Modest wage development, especially in relation to resource utilisation, contributes to the same assessment. To ensure that inflation in the coming years continues to develop in a stable manner around the 2-percent mark, monetary policy needs to continue to provide support to economic activity so that it can feed through to price growth.

Target achievement has been good in recent times, but in order for inflation to continue to develop in line with the target, further support is needed from an expansionary monetary policy for a while longer. In my view, changing monetary policy in a less expansionary direction at this stage is associated with risks and may lead to setbacks regarding the development of inflation. My opinion is that international risks are also on the downside.

Sweden is a small, open economy whose economic development is affected to a large extent by events abroad. An important factor for Swedish inflation to develop more permanently in line with the inflation target is for inflationary pressures abroad to rise from their recent moderate levels. With today's goods and services markets, it is difficult to believe that Sweden could have a rate of inflation that, on a more permanent basis, clearly exceeds that of other countries. Our forecasts rest on the assumption that a continued expansionary monetary policy abroad will lead to rising international inflationary pressures going forward. But there is uncertainty associated with this assessment, as inflation remains low in many countries despite strong economic activity. Another significant factor is the development of the krona. The Swedish krona exchange rate has been unusually volatile, and so far this year has developed more weakly than expected. Against the backdrop of factors such as weak inflationary pressures, my assessment is that too rapid an appreciation in the period ahead may make it more difficult to stabilise inflation around 2 per cent. There is also tension here between the major currency areas. It is reasonable to assume that, as is the case today, Swedish rates will be closer to the level within the EMU than in the United States.

Overall, monetary policy needs to remain expansionary for a while longer. But the low level of interest rates entails the continued build-up of debt and risk, which is troubling and associated with growing financial market risk. Much of the high indebtedness among households is due to structural problems on the Swedish housing market. To come to grips with these, measures within housing policy, taxation policy and macroprudential policy are required. Our monetary policy and financial stability reports have discussed these issues many times in recent years and I will therefore not repeat the arguments here.

The conclusion for monetary policy is that it is too early to change course now; continued vigilance and caution are necessary. Inflation is now well in line with the target, but our task is to ensure that it continues to develop in a stable manner around 2 per cent. And for this to happen, continued support is required in the form of an expansionary monetary policy. Today, Sweden has better growth, lower unemployment and a higher rate of inflation than in the EMU. In light of this, it is also reasonable to assume, if this development continues, that Sweden should have a slightly higher interest rate than within the EMU. At the same time, however, our target achievement currently feels fragile. Against this background, a normalisation of monetary policy will require considerable caution.

§3. Discussion

Governor Stefan Ingves:

I subscribe to Mr Jansson's and Ms af Jochnick's opinion that it may be difficult to achieve the inflation target in the long term if prices for services continue to develop weakly.

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

The Executive Board decided

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

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

Deputy Governor Martin Flodén entered a reservation against the repo rate path in the Monetary Policy Report. He advocated a repo rate path that indicated an initial increase of the repo rate by 0.25 percentage points in September or October this year but that coincided with the report's repo rate path as from the third quarter of 2019.

Deputy Governor Henry Ohlsson entered a reservation against the decision to maintain the repo rate at its current level and against the repo rate path in the Monetary Policy Report. He recommended raising the repo rate to −0.25 per cent with reference to the strong economic developments in Sweden and abroad.

§5. Decision to extend the mandate for foreign exchange interventions

The Executive Board decided

• to extend the mandate until 12 February 2019 in accordance with the proposal, Annex A and B to special minutes no. 5.

Deputy Governors Martin Flodén and Henry Ohlsson entered reservations against the decision to extend the mandate for foreign exchange interventions. Mr Flodén cited the same reasons as he did regarding previous decisions on the mandate. Mr Ohlsson considered that in a situation with inflation and inflation expectations close to the target level, potential interventions on the foreign exchange market can be managed without a special mandate.

§6. 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 Tuesday 3 July 2018, and

• to publish the minutes from today's meeting at 09.30 on Thursday 12 July 2018.

This paragraph was verified immediately.

Minutes taken by

Maria Kindborg

Verified:

Stefan Ingves Kerstin af Jochnick Martin Flodén

Per Jansson Henry Ohlsson Cecilia Skingsley

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