Monetary policy minutes

December 2016

SVERIGES RIKSBANK

Summary

At the monetary policy meeting on 20 December, the Executive Board of the Riksbank decided to continue purchasing government bonds during the first six months of 2017, both nominal and real bonds, each corresponding to SEK 15 billion. In addition, reinvestments of maturities and coupon payments on the government bond portfolio will amount to around SEK 30 billion during 2017. The repo rate is retained at −0.50 per cent and there is still a greater probability that the rate will be cut than that it will be raised in the near term. Increases in the repo rate are not expected to begin until the beginning of 2018.

It was noted at the meeting that the Executive Board agreed on the picture of economic developments in Sweden and abroad, and the outlook for inflation described in the draft Monetary Policy Report.

Since the previous monetary policy meeting in October, the economic outlook abroad has brightened somewhat. However, developments ahead are fraught with uncertainty, which is noted in different ways during the meeting and was also made clear in the account of questions discussed during the drafting process.

In Sweden, the Riksbank's monetary policy, with a negative repo rate and purchases of government bonds, has contributed to a high level of growth, falling unemployment, higher inflation and rising inflation expectations, not least in the longer run where inflation expectations are now close to 2 per cent. The strong economic activity means there are good conditions for inflation to continue rising. It is expected to reach 2 per cent in the middle of 2018, more or less regardless of which measure of inflation one uses.

But there are still risks that can jeopardise the upturn in inflation. The outcomes for inflation have been lower than expected in recent months and this illustrates the uncertainty over how quickly inflation will rise. It is difficult to know, for instance, how the krona exchange rate will develop in an environment where the ECB has extended its asset purchase programme and the Federal Reserve has raised its policy rate. A slow appreciation is expected going forward, and it is important to the upturn in inflation that this appreciation is slow.

All of the Executive Board members assessed that it was now appropriate to hold the repo rate unchanged at –0.50 per cent and to reinvest maturities and coupon payments on the government bond portfolio until further notice. During 2017 these are unevenly distributed over the year, so the reinvestments should be spread out. The discussions also concerned the repo-rate path, but there were only very slight differences in the members' opinions and all supported the proposed repo-rate path in the draft Monetary Policy Report. Increases in the repo rate are not expected to begin until the start of 2018.

Moreover, a majority of the Executive Board members considered that the risks to the upturn in inflation call for a continuation of the government bond purchases during the first half of 2017 and that they should be extended by SEK 30 billion, corresponding to SEK 15 billion in nominal bonds and SEK 15 billion in real bonds.

Three members entered reservations, with slightly different motives, against the decision to extend the government bond purchases by SEK 30 billion.

Also discussed at the meeting, as on several previous occasions, were the risks linked to low interest rates over a long period of time and the risks linked to inflation undershooting the target over a long period of time. As on previous occasions, several members of the Executive Board expressed continued concern over the growing household indebtedness and emphasised the need to combine measures in different policy areas to attain a long-term sustainable development of the Swedish economy.

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MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 8

DATE: 20 December 2016

TIME: 09.00

PRESENT: Stefan Ingves, Chair
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

Sarah Kuala, Central Bank of Kenya
Grace Okara, Central Bank of Kenya
Elizabeth Nilsson

Meredith Beechey Österholm
Carl-Johan Belfrage
Claes Berg
Sophie Brauner
Charlotta Edler
Mattias Erlandsson
Eric Frieberg
Joanna Gerwin
Kerstin Hallsten
Lina Jacobson (§ 1)
Ola Melander
Pernilla Meyersson
Marianne Nessén
Christina Nyman
Henrik Siverbo
Maria Sjödin
Ingvar Strid
Ulf Söderström
Anders Vredin

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

§1. Economic developments

Lina Jacobson from the Markets Department began by presenting the latest developments on the financial markets. Political events have been in focus recently. In the United States, newly elected president Donald Trump's expected fiscal policy stimulus has contributed to a stronger dollar and higher interest rates. In Italy, a quick solution was found to the government crisis and market reactions were therefore subdued. The Federal Reserve's rate rise and expectations of a faster rate of increase next year, in combination with further monetary policy stimulus from the ECB, have contributed to a marked upturn in long-term interest rates in the United States. The yield differential between a ten-year government bond in the US and Germany is now greater than for many years. The US dollar has appreciated considerably. The appreciation began after Trump's victory in the presidential election and has continued after the Federal Reserve raised the policy rate and the Bank of Japan announced an unchanged monetary policy. In Sweden, the krona is still weak, partly due to large flows within the pension systems. With regard to today's monetary policy decision, a majority of analysts are expecting an announcement of extended bond purchases while the repo rate is expected to be left unchanged.

Mattias Erlandsson, Acting Deputy Head of the Monetary Policy Department, began by presenting the draft Monetary Policy Report which, in the assessment of the Monetary Policy Department, would gain the support of the majority of the Executive Board members. He noted that international economic activity has strengthened slightly and growth indicators have picked up in many countries. Developments in the global economy have thereby been more or less in line with the picture painted in the Monetary Policy Report in October, namely that the recovery abroad is continuing, but at a moderate rate.

The forecast for international growth is now marginally higher in 2017 as a result of stronger indicators in the US and the euro area. The US forecast has also been revised upwards somewhat as fiscal policy is now expected to become slightly more expansionary in the years ahead, although the development is associated with major uncertainty. The announced policies have contributed to a marked increase in long-term interest rates in the US since October. Long-term interest rates have also risen in several other countries, but to a lesser extent. In this environment, the US dollar has strengthened.

Recently, inflation abroad has increased slightly, but is still low, especially in the euro area. It is expected to rise in the period ahead as a result of slightly higher energy prices and at pace with gradually higher resource utilisation in many countries. Monetary policy abroad is expected to remain very expansionary to support the recovery and boost inflation. Compared with the assessment in October, the forecast for the aggregate policy rate abroad has been marginally revised upwards.

Concerning the risk outlook, the assessment is that there is still considerable uncertainty over economic policy. A case in point is the continued uncertainty regarding the forms for a British withdrawal from the European Union. The withdrawal will probably be associated with reduced trade and limited movement of labour, however. The newly elected US president has announced proposals that point in the same direction. Greater protectionism is therefore considered to pose a risk to global growth in the long term. The effect on inflation abroad is unclear. The European banking sector, not least in Italy, is still struggling with weak profitability and a large proportion of non-performing loans. This is posing a risk to the recovery in the euro area.

The outlook for Swedish economic activity is also somewhat brighter. Growth in the third quarter was 2.0 per cent compared with the second quarter and calculated as an annual rate, which was slightly higher than the forecast in October, and confidence among households and companies has increased significantly in recent months. Growth in the Swedish economy is therefore expected to remain strong. A growth rate of 3.4 per cent is expected this year, a tenth higher than in the October forecast. Growth for 2017 has been revised upwards by 0.4 percentage points to 2.4 per cent. The high growth in recent years has led to an increase in resource utilisation, which is now deemed to be slightly higher than normal and will continue to rise somewhat in the coming years.

The labour market is continuing to strengthen. The recent monthly outcomes indicate good employment growth and unemployment is expected to amount to 6.8 per cent during the fourth quarter of 2016. In the forecast, unemployment continues to fall slightly, but a significant inflow into the labour force of people with a weak status on the labour market means that the further downturn in unemployment will be moderate, which is in line with the previous forecast.

Household indebtedness continues to rise, and is expected to amount to 194 per cent of annual disposable income in the fourth quarter of 2019.

The krona has continued to weaken, not least against the US dollar. It has depreciated slightly more than expected and compared with the forecast in October, it is expected to be somewhat weaker during the entire forecast period. The picture of the krona gradually strengthening in an orderly fashion remains, however.

CPIF inflation has risen since the beginning of 2014. Since the Monetary Policy Report in October, we have had two inflation outcomes. The latest outcome was for November and recorded a CPIF inflation rate of 1.6 per cent, marginally weaker than the forecast in October. The conditions are deemed to be in place for a continued increase in inflation in the period ahead. Increasingly strong economic activity is contributing to the upswing in inflation, even though the effect is occurring with a certain time delay. Rising inflation abroad in the period ahead is another important factor. Furthermore, the weaker krona is expected to make a positive contribution to inflation during 2017. The forecast for inflation is very similar to the forecast in October. CPIF inflation is expected to reach 2 per cent in 2018.

The forecasts in the draft Monetary Policy Report are based on the assumption that the repo rate will be held unchanged at −0.50 per cent. The assumed repo rate path reflects the fact that there is still a greater probability of the rate being cut than of it being raised in the near term. Not until the beginning of 2018 is the repo rate expected to be raised at a slow pace. Furthermore, purchases of government bonds are being increased by SEK 30 billion during the first half of 2017, evenly distributed between nominal and real government bonds respectively. In addition, maturities and coupon payments on the government bond portfolio are expected to be reinvested until further notice. During 2017, these maturities and coupon payments will amount to around SEK 30 billion. There will be a large maturity in August, but reinvestments are expected to begin at the start of the year and continue throughout the year.

Mr Erlandsson then noted that the forecasts in the draft Monetary Policy Report have been discussed by the Executive Board at meetings held on 8, 9, 12 and 16 December. The draft Monetary Policy Report was tabled at a meeting of the Executive Board on 14 December.

Important issues highlighted in the monetary policy drafting process this time include the development of inflation and the krona during the autumn, the consequences of the US presidential election, monetary policy abroad and the impact of Swedish monetary policy thus far.

Inflation has been weaker than previously expected during the autumn, even if the last two outcomes have been more or less in line with the October forecast. During the drafting process, different board members pointed out the importance of following the development of domestic inflationary pressures. In this context, the development of prices for services has been identified as particularly important. A key issue has therefore been analysis of how the unexpectedly low inflation during the autumn is linked to factors such as resource utilisation and labour costs. The impact of the exchange rate on inflation has also been analysed. The Swedish krona has recently been unexpectedly weak. The drafting process has included discussions of possible explanations for this development and what significance it has for inflation. Analyses of the impact of the exchange rate on inflation are presented in an article in the draft Monetary Policy Report.

Another important issue in the drafting process has been the consequences of the US presidential election. The newly elected president has announced policies that could entail both more expansionary fiscal policy as well as greater trade barriers and a reduced labour force in the United States. There was a discussion on whether the proposals announced would be realised and how this should be taken into consideration in the Riksbank's forecasts.

Participants on the financial markets now expect faster rate increases from the Federal Reserve in the years ahead. The Federal Reserve raised the interval for its policy rate in December, while the ECB decided to prolong its asset buying programme. It is therefore becoming increasingly obvious that the large central banks around the world are in different phases. How this development is affecting the conditions for Swedish monetary policy, including via the effects on the exchange rate, has been an important issue in the drafting process this time.

Finally, different board members have highlighted the issue of the impact of Swedish monetary policy so far, as well as what effects can be expected from further monetary policy measures.

§2. The economic situation and monetary policy

Deputy Governor **Cecilia Skingsley** began by noting that the Riksbank's assessment of the global economic and inflation situation has been revised upwards slightly in the near term since the previous monetary policy meeting.

The relatively unexpected election victory in the United States for the Republican Party presidential candidate Donald Trump and, according to opinion polls, the more expected referendum defeat for the incumbent Italian prime minister Matteo Renzi have been handled well by the global financial markets, according to Ms Skingsley. Both events, which increase uncertainty regarding the political direction of two out of three of the world's largest government bond issuers, have passed in a controlled way. Similar to what could be observed after the Brexit decision earlier this year, the financial sector seems to have improved its ability to price increased uncertainty without itself contributing to greater instability. It is crucial for the economic recovery that the financial system is able to absorb unexpected and/or difficult events in a stable way without impairing its ability to price and channel capital and risk, Ms Skingsley emphasised.

Since the Riksbank's monetary policy meeting in October, long-term market rates abroad have risen, due partly to expectations of higher inflation in the period ahead. This is also true for Sweden, where both survey-based and market-based measures of inflation expectations have increased slightly.

Rising expectations of fiscal policy expansion in the United States is mentioned as an important explanation for the rate increases. Ms Skingsley found this explanation reasonable, but she also wished to point out that there will be considerable uncertainty surrounding the incoming administration's economic policy for a long time. She stressed that it is good that the section on uncertainty and risks in the draft Monetary Policy Report refers to the US economy and politics as an important risk factor for economic development in Sweden.

Declarations of intent towards less globalisation and more closed economies, as indicated by several recent election results, may lead to higher, near-term inflationary pressure. In the longer term, however, more barriers for both people and trade point towards lower growth potential. According to Ms Skingsley, however, it is too early to make any forecast predictions based on the likelihood of increased protectionism. She therefore intended to treat this as a risk factor for the time being.

The economic picture has also brightened slightly for Sweden since the Monetary Policy Report in October. The labour market is continuing to improve. If we consider the survey-based labour shortage figures in the business sector, we have to go back to 2007 and before the global financial crisis to find similarly high levels. This suggests a continued increase in wage and price pressures in Sweden, according to Ms Skingsley. The outcomes for inflation are, however, still quite fitful and difficult to analyse. The unexpected weakening of prices for services earlier this autumn underlines the importance of the krona not becoming a threat to a continued trend increase in inflation. It is therefore positive that the krona exchange rate has developed more weakly than expected in recent months, she said.

The various combinations of conceivable monetary policy discussed by the Executive Board this time are not easily captured or evaluated in different models. It is a question of risk assessments and it is reasonable for a group of six people to have different risk preferences, Ms Skingsley reasoned. This is one of the strengths of the Riksbank's management structure. The proposed monetary policy decision in the year's final report entails an expansion of the bond purchasing programme by SEK 30 billion during the first half of 2017. Ms Skingsley considered it to be possible to support the proposal in view of the fact that the inflation upturn in Sweden is still fragile and that Sweden should not risk deviating too much from interest rate developments in the euro countries. However, she made the assessment that the potential advantages of such an expansion of the bond purchasing programme were too uncertain in relation to its potential costs, an argument on which she then elaborated further.

The Riksbank's interest rate cuts and bond purchases in recent years have, according to Ms Skingsley, driven up domestic demand to levels at which various signs of shortages have begun to emerge. In her assessment, the unexpectedly slow increase in inflation can hence not be explained by overly weak domestic demand. She considered that the scope for monetary policy in Sweden has increased in relation to the euro area as GDP growth and cost pressures have risen and confidence in the inflation target has clearly strengthened. Given the improved economic development, Ms Skingsley also thought that the repo rate forecast in the draft Monetary Policy Report, which implies a probability for further repo rate cuts in the near term, is excessively low in relation to her opinion of what is a well-considered monetary policy going forward.

Furthermore, Ms Skingsley underlined the fact that, while she shared the assessment that additional bond purchases would reduce the risk of an unwanted, rapid appreciation of the Swedish krona, she considers the Executive Board's intervention mandate an inhibitory factor. Ms Skingsley also said that she is prepared to extend this mandate during 2017.

She then said that continued bond purchases are linked to the question of whether they impair the functioning of the fixed-income market and increase liquidity risk. If so, this would lead to higher market rates, exactly the opposite of the Riksbank's intention with the purchases. Ms Skingsley did not consider herself to be convinced that the functions of the market had deteriorated but noted that market participants themselves felt this to be the case, according to the Riksbank's risk survey published on 16 November. This can lead to a change in behaviour that may disadvantage interest-rate setting in Sweden and is therefore something that the Riksbank needs to follow carefully, she stressed.

Ms Skingsley then summarised her contribution. She supported the report's analysis, forecasts and the proposal for an unchanged repo rate and reinvestments of coupons and maturities during 2017. However, she did not support the draft proposal to purchase more government bonds for SEK 30 billion.

Deputy Governor **Per Jansson** began by noting that two new inflation outcomes have been published since the monetary policy meeting in October, for the months of October and November. Both outcomes were slightly lower than the forecast in the latest Monetary Policy Report. In November, CPIF inflation amounted to 1.60 per cent, while CPIF inflation excluding energy prices was 1.21 per cent. The forecasting errors for both inflation measures were in the region of 0.1-0.2 percentage points. Inflation therefore continues to surprise on the downside, Mr Jansson observed. Including the outcomes in October and November, inflation has now been below the Riksbank's forecasts for four months in a row.

Even though the development of inflation during the late summer and autumn has obviously been a disappointment, there are some bright spots, he pointed out. These are mainly linked to the latest outcomes in November. Despite them being lower than expected, a relatively clear upturn could be seen in all the inflation measures, in contrast to the October figures. As a result, the upward trend in inflation, noticeable since the beginning of 2014, is for now once again clearer.

The fact that service price developments have become significantly stronger is of considerable importance in this context, Mr Jansson stressed. In October, the growth rate of prices for services had fallen to a 12-month low of around 1.5 per cent. In November, it rose to 2.2 per cent, which, with the exception of March, is the fastest increase so far this year. Another positive in November was food prices continuing to rise and surprise on the upside. This had already started in October but the tendency persisted in November. It is clear that the recent unexpected weakness of the exchange rate is playing a part here and this hopefully points to a more favourable development of prices for both food and goods going forward.

Also worth noting is that HICP inflation reached an annual high in November of 1.3 per cent, he continued. With this, Sweden has climbed 2 places in the EU inflation league table, from sixth to fourth, since the previous monetary policy meeting.

Two new outcomes for inflation expectations have also been published since the meeting in October, Prospera's monthly survey in November of money market participants and the larger quarterly survey in December. With the odd exception, expectations continued to rise one and two years ahead. The important expectations of inflation five years ahead, which can be regarded as a measure of the credibility of the inflation target, fell overall by half a tenth of a percentage point. Mr Jansson noted that the fall is largely due to slightly more pessimistic expectations among purchasing managers in the manufacturing industry and among employer organisations.

The fall in long-term inflation expectations is of course nothing to be happy about. But on the whole it is small and expectations generally remain close to 2 per cent, he pointed out. It is particularly important that inflation expectations among the social partners do not become too low. The most recent quarterly survey in December indicates that trade unions are expecting inflation in five years' time to be 2.15 per cent, while the corresponding figure for employer organisations is 2.08 per cent. It is extremely important for the wage bargaining rounds in 2017 that the social partners continue to view the inflation target as credible.

Mr Jansson summarised in light of this the current inflation picture as decent, despite inflation falling somewhat short of expectations.

If we look beyond Sweden's borders, the Federal Reserve raised the interval for its policy rate by 25 basis points to 0.50-0.75 per cent in December, as expected. The members of the monetary policy committee also said that they now believe that they will be raising the policy rate at a slightly faster pace than was previously assumed. With regard to fiscal policy in the United States, there is still considerable uncertainty, which the Federal Reserve emphasised in its communication regarding the policy rate decision. Market expectations of the Federal Reserve's interest-rate policy are still at a lower level than the central bank's own expectations, but have been revised up substantially following the presidential election. All else being equal, the market thus appears to believe that the new fiscal policy must be met by a larger number of interest-rate hikes than the Federal Reserve has so far assumed, said Mr Jansson.

In the euro area, the ECB decided to continue its asset purchases beyond March 2017, when the current programme expires. The asset purchase programme will go on for the whole of 2017 at least, although the rate of investment is expected to decline from EUR 80 billion to EUR 60 billion per month. The ECB has made it clear that the programme can be extended in terms of both size and maturity if inflation prospects were to deteriorate. At the same time, the central bank decided to adjust the parameters of the asset purchase programme, so that it can continue to be implemented smoothly. Mr Jansson observed that one purpose of this is to make it possible for the ECB to buy securities with a yield that is below the deposit rate.

The changes in monetary policy in Sweden and abroad, together with speculations that Britain's withdrawal from the EU requires transitional arrangements and is not about binary choices, have in total led to the krona exchange rate depreciating since October, and now being weaker than expected, he continued. The weaker krona provides some positive inflationary impulses in the slightly shorter time perspective, which may be important in a situation where it will still take some time before economic activity has a full impact on price developments.

The forecast still assumes that the krona will appreciate somewhat in the coming years. As in October and September, Mr Jansson was doubtful about the forecast for the exchange rate. His view is that the long-term scope for appreciation of the real exchange rate may have declined in recent years.

Mr Jansson assessed that the conditions for a rising trend in inflation remain good on the whole. Inflation outcomes have been slightly lower than expected since October, but the current inflation picture nevertheless has some bright spots. Inflation increased fairly tangibly in November, and this means that the upward trend is now clearer once again. The rate of increase in service prices also picked up significantly, and the recent weak krona is beginning to make a mark in some areas of price development. The Federal Reserve has raised its policy rate and it is possible that the policy rate may increase at a faster pace going forward than the monetary policy committee members currently envisage. At the same time, the ECB has extended its purchases of securities, but the pace of investment is expected to decline after the current programme expires in March next year. In addition, as pointed out in the draft Monetary Policy Report, the economic signals in Sweden and abroad have recently been somewhat better than expected, which supports the current upturn in inflation. He emphasised that the fact that more long-run inflation expectations remain in line with the inflation target is also important. This applies not least to social partners' expectations. Given this, Mr Jansson considered that the repo rate should be held unchanged at today's meeting.

Having said this, he underlined that the upturn in inflation is still fragile and that there are risks of setbacks. This has become clear, for instance, from the fact that the Riksbank has overestimated the outcomes for inflation four months in a row. The ECB is now extending its asset purchase programme and adjusting its parameters to allow for a more flexible implementation. At the same time, there is considerable uncertainty over how quickly the Federal Reserve will raise its policy rate and so far the assumption is that it will do so slowly. It is difficult to know how the krona exchange rate will develop in this environment. This means that the relatively substantial probability of a further cut in the repo rate in the near term, as proposed in the draft Monetary Policy Report, should still stand. Mr Jansson was also in favour of increasing the purchases of government bonds. The draft Monetary Policy Report proposes extending these purchases by SEK 30 billion during the first half of 2017. The purchases are assumed to include both nominal and real government bonds, corresponding to SEK 15 billion of each type. Until further notice, maturities and coupon payments from the government bond portfolio will also be reinvested. During 2017 these will amount to around SEK 30 billion. There will be a large maturity in August, but reinvestments are suggested to start at the beginning of 2017 and to continue throughout the year. This should mean that the rate of investment during the first half of 2017 is about the same as during the second half of 2016. The proposals mean that the Riksbank's purchases will amount to SEK 275 billion, excluding reinvestments, in the middle of 2017.

Mr Jansson supported extending the purchases of government bonds in accordance with the draft Monetary Policy Report. He also supported the forecasts and other monetary policy assumptions in the draft report.

First Deputy Governor **Kerstin af Jochnick** began by saying that she supports the assessments in the draft Monetary Policy Report and that she supports the proposals to hold the repo rate unchanged at –0.50 per cent, to adjust the repo-rate path and to extend the purchases of government securities by SEK 30 billion during the first half of 2017. She also supported the decision to spread the reinvestments from maturities over the year.

Developments since the monetary policy meeting in October have on the one hand been marked by uncertainty following the election in the United States and on the other hand by somewhat stronger outcomes for real economic data abroad, noted Ms af Jochnick. International inflation is on the increase, but this is largely due to rising energy prices. World trade in goods recovered somewhat in the third quarter of this year after having fallen for two quarters in a row. The indicators point to a continued recovery at the end of the year. However, she noted that there have also been warnings following various political announcements that the global economy may suffer further protectionism and thereby lower world trade going forward.

Macro data in the United States have developed well, which paved the way for the Federal Reserve’s policy rate increase last week. GDP growth for the third quarter was 3.2 per cent compared with the second quarter and calculated as an annual rate, and unemployment is at an historically low level. CPI inflation was 1.7 per cent in November.

If all of the proposals that newly-elected president Donald Trump launched in his election campaign were implemented, they would have contradictory effects on economic growth, said Ms af Jochnick. A more expansionary fiscal policy has positive effects on growth, while greater protectionism and stricter immigration laws dampen growth. However, it is difficult to make a proper assessment as we do not know which proposals will actually be implemented, she said. This means that the Riksbank’s assessment of global developments contains a good measure of uncertainty linked to US politics in 2017 and onwards. All in all, however, GDP in the United States is expected to grow slightly faster in 2017 and 2018 compared with the previous forecast. To the uncertainty about global developments one should add the politically complicated process for managing the United Kingdom's withdrawal from the EU. It will take a long time before one can take stock of the effects of a withdrawal agreement.

Ms af Jochnick went on to say that macro data for Sweden look fairly good. Growth is strong and it now appears as though demand from Sweden's most important export markets is also increasing, albeit slowly from an historical perspective. The labour market is marked by high employment, although it is still divided, with increased unemployment among vulnerable groups. Shortages are increasing in several sectors and resource utilisation is somewhat higher than normal at present. It is also good that both the corporate and household sectors are showing rising optimism according to various confidence indicators. She said that this should on the whole lead to higher inflation if historical relationships still apply.

Despite the relatively good development of the Swedish economy, inflation is rising slowly. Inflation has been somewhat weaker than anticipated during the autumn. Service prices in particular have shown a modest development on several occasions. This means there is still a risk that inflation will be weaker than expected going forward, said Ms af Jochnick. In October the Riksbank assessed that inflation would rise towards 2 per cent, but that it would take longer than previous assumed. The Executive Board therefore decided at its October meeting to revise the repo-rate path both by indicating a greater probability that the repo rate would be cut further in the near term and by postponing the first repo-rate increase for six months, until the beginning of 2018. Moreover, the Executive Board declared its willingness to extend the purchases of government bonds.

The Riksbank's assessment is that developments in Sweden and abroad have improved somewhat since the monetary policy meeting in October. CPIF inflation is now expected to increase slowly and reach 2 per cent in mid-2018. However, Ms af Jochnick emphasised that there are several reasons why it is still uncertain how quickly inflation will rise going forward. One central factor is monetary policy abroad. Following the October meeting, both the ECB and the Federal Reserve have made new decisions on monetary policy that the Executive Board must now include in its monetary policy decision.

During the autumn, the krona has been weaker than the Riksbank forecast. The Riksbank's assessment is now that the krona will appreciate further ahead, but as reported in the article in the draft Monetary Policy Report, the krona is affected by many different factors both in Sweden and abroad. Ms af Jochnick's assessment is that the Riksbank still needs to safeguard a stable development of the krona so that it does not appreciate too quickly.

All in all, she assessed that developments since the October monetary policy meeting were largely in line with the Riksbank's forecasts. The Swedish economy is developing well, but inflationary pressures are still weak and abroad there are questions regarding both world trade and other central banks' monetary policy. As in October, therefore, it is still uncertain how quickly inflation can return to the target. As developments have been close to the Riksbank's forecasts, Ms af Jochnick found no reason to consider a further repo-rate cut at this meeting to influence interest rates in the short term.

On the other hand, she assessed that the inflation forecast was still uncertain, due to several factors. In Ms af Jochnick's opinion, the Riksbank has so far been successful in its asset purchases and managed to create good conditions for increased resource utilisation and a development of the krona that enables attainment of the inflation target. She therefore assessed that it was not appropriate to bring the asset purchases to an end now, particularly not in an environment where the ECB's asset purchases remain relatively extensive. The ECB has both extended its asset purchase programme and said it is prepared to extend the purchases further if necessary. If the Executive Board does not decide to extend the asset purchases today, there is a risk that the krona will strengthen in a way that slows down the upturn in inflation, Ms af Jochnick pointed out.

With regard to the reinvestments related to government bonds maturing in August 2017, she considered it good that the Executive Board is announcing now that the Riksbank intends to spread the reinvestment to avoid overloading the market with large purchases on individual occasions.

Finally, Ms af Jochnick also wished to take up the fact that she shares the concern expressed in the draft Monetary Policy Report that low interest rates over a long period of time can lead to excessive indebtedness and contribute to high asset valuations. There is a risk that this creates the wrong incentives that can lead to over-valuation of both real and financial assets. The Riksbank has analysed this in its most recent Financial Stability Report. All in all, Ms af Jochnick considered that the issues raised so far by the Riksbank with regard to the dysfunctional housing market and the repercussions on household indebtedness were some of the largest risks to the Swedish economy. The European Systemic Risk Board's (ESRB) warning to Sweden in November emphasises that measures are urgently needed to reduce the risks linked to household indebtedness and the poorly-functioning housing market. As the Riksbank has done before, the ESRB highlights the housing market, taxation of housing and macroprudential policy. The problems in Sweden cannot be resolved by simple measures, but require a mix of appropriate measures that will contribute over time to reducing the risks to the Swedish economy, concluded Ms af Jochnick.

Governor **Stefan Ingves** began by saying that he intended to begin with a broader approach and some background information before discussing today's decision. He began by asking: what degrees of freedom does monetary policy actually have in a small, open economy? The experiences of recent years show that in a world with free movement of capital, the wriggle room for domestic monetary policy is affected by monetary policy in other countries. The exchange rate in a small country like Sweden is affected to a large degree by the monetary policy conducted in the United States and the euro area.

During several periods, it has been the case that when monetary policy in large currency areas changes direction or is expected to change in a more expansionary or less expansionary direction, substantial market reactions in other countries can be observed. Another lesson learned is that when interest rates abroad impact Sweden and other open economies, it is important to have one's own house in order. The inflation target can only function as an anchor in the economy if monetary policy is backed up by a credible fiscal policy and a stable financial system.

We learned this lesson in Sweden in a very concrete way in 1994/95. At the beginning of 1994, the Federal Reserve was the first central bank to raise its policy rate. Long-term interest rates began to rise. Interest rates rose more in Sweden than in many other countries. We had an unfavourable inflation history, large budget deficits and financial imbalances remaining from the banking crisis. The annual government borrowing requirement was at a very high level. This contributed to rising inflation expectations and a weaker krona. The inflation target was threatened right from the start. Given the increasing inflationary pressures, the Riksbank raised the repo rate in August 1994. But special calculations were made to estimate how far the repo rate could be raised without causing the Swedish banks to collapse again. There was thus at that time a form of upper bound for the policy rate, which appears very far from today's situation where so much of the discussion concerns the lower bound for the policy rate.

According to Mr Ingves, public finances needed consolidation in the mid-1990s to create the conditions for lower inflation expectations, for long-term interest rates to decline and for the krona to appreciate – so that the inflation target would become credible.

There are also more immediate examples of the dependence of monetary policy on international events and of how countries that do not have their own house in order are affected more than others. In 2013 there was uncertainty over when the Federal Reserve would begin tapering its asset purchases. Rising interest rates and a relative strengthening of the economic prospects in the developed economies contributed to capital outflows and currency turbulence in several emerging markets. This applied in particular to countries with large current account deficits, high inflation and a large share of short-term liabilities.

A further dilemma can arise if monetary policy in large currency areas is in different phases. At the beginning of 2014, the Federal Reserve had begun phasing out its monthly asset purchases, while the policy rate in the United States was expected to remain at its low level for a long period of time. The ECB, on the other hand, maintained a preparedness to cut its policy rate further and opened up the possibility of asset purchases from banks to facilitate lending. Expectations of more expansionary monetary policy from the ECB contributed to strengthening the krona, particularly against the euro.

In the middle of 2014, it had become even clearer that central banks around the world were in different phases. The Federal Reserve continued tapering its asset purchases and it was expected that increases in the US policy rate would begin in the second half of 2015. The ECB, on the other hand, cut its policy rate and announced an extensive support package to facilitate access to bank loans for small and medium-sized enterprises. At the beginning of 2015, the ECB had decided to conduct substantial asset purchases to make monetary policy more expansionary and to ensure that inflation began to rise. Given the monetary policy conducted abroad, there was a risk that the krona would become too strong. One can say that the krona was positioned between the dollar and the euro. In a situation with low inflation in both Sweden and the euro area, the Riksbank's assessment was that the krona needed to be closer to the euro, and this still applies.

It was then appropriate to cut the repo rate below zero for the first time and to begin purchasing government bonds. This was in a situation where inflation was below the target and inflation expectations were wavering.

The Riksbank's repo-rate cuts and asset purchases, which began at the start of 2015, have indeed had the desired effect by reducing interest rates and spreads vis-à-vis interest rates abroad and weakening the krona. The lesson learned is that the purchases of government bonds have worked very well as a complement to the repo-rate cuts with regard to pushing down the Swedish yield curve.

After presenting this background, Mr Ingves moved on to today's decision. Since the previous monetary policy meeting, real economic developments abroad have been slightly stronger than expected. There are signs of stronger developments next year in economies that are important to Sweden's exports, such as the United States, the United Kingdom and the euro area.

In the euro area, the recovery is expected to proceed more or less in line with the earlier forecast. The low inflation in the euro area has caused the ECB to further extend its quantitative easing. Although the recovery in the euro area is continuing, there are still imbalances following the crisis, particularly in the banking sector. There is also uncertainty over political developments and public finances in several countries and over the management of the refugee crisis. In the United States, the recovery is expected to continue during the forecast period, slightly stronger than forecast in the October Monetary Policy Report. Consumption will continue growing, given good labour market developments. Following the presidential election in the United States, fiscal policy is expected to become more expansionary even if it is uncertain how long the effects will be positive for growth, as the long-term stability of the public finances may deteriorate. In addition, there is uncertainty over how far increased protectionism could hamper trade and growth.

Government bond yields in the United States have risen during the autumn. The upturn has spread to other countries and taken with it international bond yields with longer maturities. In several emerging markets, particularly those that do not have their own house in order, stock prices have been dampened and the exchange rate against the dollar has weakened. The Swedish yield curve has also become steeper. The increasingly strong development in the US economy contributed to the Federal Reserve deciding last week to raise the interval for its policy rate and it is now expecting that the rate increases during 2017 will be at a faster pace than previously announced.

This means that we are now in the scenario first discussed at the beginning of 2015, when expectations of the differences in the monetary policy conducted by the ECB and the Federal Reserve begin to be tangible, continued Mr Ingves.

In Sweden, domestic economic activity is strong. The demand for labour remains high. High public sector consumption and expansionary monetary policy have contributed to a high level of domestic demand. Over the coming years, the international recovery will be particularly important for the development of the Swedish economy. GDP is expected to grow by 3.4 per cent this year. Thereafter, the growth rate will decline gradually to 2.1 per cent in 2019.

CPIF inflation has shown a rising trend since 2014. This is partly because of the expansionary monetary policy, the fact that resource utilisation has risen and the krona has weakened. Unfortunately, inflation in Sweden has been somewhat weaker than expected in recent months, said Mr Ingves. On several occasions, services prices were lower than expected. However, the Riksbank is now assuming that the conditions are right for a continued upturn in inflation. Resource utilisation is continuing to rise, which pushes up inflation, even if there is some time lag. The krona has weakened during 2016, which is also expected to contribute to rising inflation, primarily in 2017. However, the krona is expected to appreciate at a modest pace during the coming years, but when this happens, international price pressures rise and contribute to higher inflation in Sweden. Inflation is now expected to increase slowly and reach 2 per cent in mid-2018. The last time CPIF inflation was at 2 per cent was in 2010.

According to Mr Ingves, monetary policy needs to continue providing strong support for inflation to rise towards 2 per cent. This implies that the repo rate should be held unchanged at −0.50 per cent. The forecast entails the first repo-rate increases being made in early 2018. But there is still uncertainty over what impact resource utilisation and the exchange rate will have on inflation. After a period with low inflation for a long time, it is of course pleasing that inflation is rising. But Mr Ingves still sees a risk of inflation being lower than anticipated. He mentions three potential risk factors that contribute to uncertainty over the strength of the inflation upturn.

The first risk factor concerns the initial theme of monetary policy abroad and the Swedish krona. In the euro area, the ECB has decided to continue its quantitative easing by allowing the asset purchase programme to continue for a further nine months, albeit at a somewhat slower pace. The ECB is also prepared to extend the purchases further if necessary. This entails a risk that the krona will be stronger than in the current assessment. An overly rapid appreciation of the krona would dampen import prices and demand. It would be more difficult to attain the inflation target than is forecast.

Another risk factor is linked to the labour market. The forecast in the draft Monetary Policy Report is based on improved economic activity leading to higher wage increases. Normally, higher wage increases are noted with some time lag in relation to economic activity. The shortages on the labour market at present suggest rising wages, but the growth rate appears lower than indicated by historical correlations. There is a risk that the correlation between resource utilisation and developments in wages is weaker than before.

A third risk factor concerns increased competition and new technology. Both services prices and goods prices sometimes develop surprisingly weakly. One explanation can be that there are substantial changes in the economy as a result of increased global competition. It is noted in the Riksbank's most recent business survey that e-commerce and increased competition have contributed to low price plans for retail trade companies and services companies that sell directly to households. This may affect inflationary pressures, at least temporarily, going forward.

Mr Ingves' conclusion regarding monetary policy as a result of the forecasts and risk outlook in the draft Monetary Policy Report is that in addition to retaining the low repo rate, it is also reasonable and well-balanced to extend the purchases of government bonds. It is clear that the earlier purchases have had the intended results. It is also clear that it is important for the Riksbank to be pro-active. The proposal now is that the purchases should be extended by a further SEK 30 billion, during the first half of 2017. In the middle of 2017, the purchases will thus amount to SEK 275 billion, excluding reinvestments. It is also reasonable to reinvest maturities and coupon payments in the government bond portfolio. This will retain the expansionary monetary policy.

Mr Ingves concluded his contribution to the debate by returning to the question of whether Sweden has its own house in order. With regard to fiscal policy, he is prepared to answer yes to this question. Since the new regulations for public finances were introduced during the second half of the 1990s, fiscal policy has functioned much better than it did before then. This does not prevent challenges from arising during the coming years, of course, that is the way things are. One example is that demographic developments could push up public expenditure.

With regard to macroprudential policy and the housing market, the answer to the question is no, however, according to Mr Ingves. The Swedish housing market is highly valued in a historical perspective. Credit growth in the household sector remains high and amounted to 7.3 per cent in October (bank loans). Housing prices increased by 7.9 per cent in November. High housing prices and increasing household indebtedness entail a very large risk to economic and financial stability. A warning was issued by the ESRB in November regarding the Swedish housing market. The ESRB pointed to the rapid increase in house prices and the high and increasing indebtedness. The IMF, too, pointed to the risks on the Swedish housing market in its Article IV report and called for reforms. It is also important to take into account the fact that the Swedish financial system is much larger now than it was in the mid-1990s. The banking system is large, concentrated, exposed to liquidity risks and increasingly exposed to the housing market. The commercial banks have almost become mortgage banks. In addition, Swedish banks have extensive operations abroad.

Mr Ingves himself has noted on many occasions that the Riksbank's expansionary monetary policy assumes that the risks in the housing market will be managed by other policy areas. Finansinspektionen has taken some measures, but more is required to mitigate the risks. A combination of different measures is required – in several different policy areas – to reduce the risks. Measures are needed within the fields of macroprudential policy, housing policy and tax policy to limit the build-up of debt in the household sector and to improve the Swedish housing market. Without such measures, there is a risk to long-term economic stability in Sweden, with a risk of contagion effects to our neighbouring countries.

Deputy Governor **Henry Ohlsson** began by saying that he supports the proposal to hold the repo rate unchanged at –0.5 per cent. Further, he considered that the maturities and coupon payments on the government bond portfolio in 2017 should be reinvested the same year. However, he did not find it appropriate that the asset purchases should be extended by SEK 30 billion during the first half of 2017.

Mr Ohlsson pointed out that this was his twelfth ordinary monetary policy meeting, that he had now completed a dozen. He therefore began his contribution with some personal reflections and conclusions from his first two years on the Executive Board of the Riksbank. This was not because he had begun writing his memoirs, said Mr Ohlsson. The reason was that these reflections and conclusions were important to his monetary policy reasoning and conclusions at this meeting.

The most recent inflation figure in November showed an annual rate of increase in the CPIF of 1.6 per cent. The corresponding figure in November 2014 showed an annual rate of increase in the CPIF of 0.6 per cent. The upturn is 1 percentage point, that is a significant rise, according to Mr Ohlsson. Over the past two years, the rate of inflation has thus gone from being far away from the inflation target to being relatively close to it.

This year’s December survey of inflation expectations one year ahead among money market participants was at 1.5 per cent. In December 2014, expectations one year ahead were at 0.7 per cent. The upturn here is 0.8 percentage point, that is a significant rise, according to Mr Ohlsson.

Unemployment according to the labour force surveys (LFS) was 6.2 per cent (not seasonally-adjusted) in November this year. The corresponding figure for November 2014 was 7.4 per cent. The decline is 1.2 percentage points. This is a significant fall, said Mr Ohlsson. He noted further that it corresponds to around 60,000 people employed. According to the draft Monetary Policy Report, GDP is expected to increase by 3.4 per cent in 2016. GDP growth in 2014 was 2.6 per cent. The upturn is 0.8 percentage point, that is a significant rise.

These outcomes for important macroeconomic variables show a very positive development for the Swedish economy in recent years. The expansionary monetary policy the Riksbank has conducted is a factor that contributes to this, said Mr Ohlsson.

He perceived that it is very rare that we have a horizon in day-to-day life that stretches as far as two years. He followed this up with some personal reflections. He said that this was certainly not meant as criticism of others, rather as self-criticism. Mr Ohlsson said that he was tarred with the same brush as others.

The day-to-day lives of economic policy-makers, chief economists, financial analysts, financial journalists, academics and other interested parties are filled with a constant flow of new data, new figures. New inflation figures are published twelve times a year, and data on inflation expectations, unemployment, economic activity, etc. are published equally often. The National Accounts are published four times a year. And the Riksbank contributes with its monetary policy decisions six times a year. Almost one third of all working days will see a "figure" published. On top of this, exchange rates, market rate and stock prices are reported in real time.

Many others, like the Executive Board of the Riksbank, have to interpret this flow as part of their jobs. If any figure is in any sense poorer than expected, even only slightly, we can read headings such as: "Riksbank under pressure". If the figure is better than expected, even only slightly, we can read headings such as: "The Riksbank can breathe out now". And often these headings describe exactly what those interested in monetary policy feel – and this includes the Executive Board.

It is so easy to forget the uncertainty linked to these figures, and the often wrong sense of exactness that arises, said Mr Ohlsson. How easily do we forget that many figures come from surveys based on small samples? Furthermore, the underlying data may be inadequate, seasonal patterns may change so that it becomes difficult to adjust for them and human error can lead to incorrect figures. And in many cases, the figures we receive are preliminary, they may be adjusted several times over a long period before the figures are considered definite. The 95-per cent confidence interval for an inflation figure is +-0.3 percentage points. The corresponding confidence interval for unemployment according to the LFS is +-0.4 percentage points.

Mr Ohlsson pointed out that he recently held a speech at Luleå University of Technology, where he discussed these issues. His choice of title was: "The tyranny of the tenths". Mr Ohlsson considers that everyone would benefit from, at least sometimes, looking up from the tenths – and the hundredths. At the same time, it is important to realise that the tenths sometimes are not just white noise, but show an important break in a trend. This was the case in February 2015, when the krona began to appreciate very rapidly. It is a challenge to differentiate between a break in the trend and white noise.

Mr Ohlsson then moved on to some reflections on the current situation. GDP growth in Sweden is currently rapid. The LFS still show a decline in unemployment. In Mr Ohlsson's opinion, however, unemployment is still too high. The differences between different groups are thus becoming clearer. Those born in Sweden have a much better chance in the labour market than those born abroad. Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. The proportion of openly unemployed members of unemployment funds was around 2.4 per cent in November. This percentage is lower than prior to the financial crisis. The conclusion from these real economic indicators is that overall resource utilisation in the Swedish economy has now passed normal levels and can be expected to be even higher in the coming years.

Inflation expectations five years ahead are currently close to but just below the inflation target. The most recent measurement in December showed the expected annual rate of inflation five years ahead to be 1.9 per cent, according to money market participants. It is satisfying that these longer-term expectations are now basically back on the inflation target, said Mr Ohlsson.

Abroad, it can be noted that the Federal Reserve raised its policy rate at its December meeting. Three further increases may be made in 2017. US long-term interest rates have risen substantially. The ECB decided at its December meeting to hold its policy rate unchanged, while it chose to extend its programme for asset purchases to the end of 2017. However, the monthly purchase rate will be slowed down.

As Mr Ohlsson noted earlier, the November CPIF figure showed an annual rate of increase of 1.6 per cent. Inflation is thus still below the inflation target. This calls for continued expansionary monetary policy. But are further monetary policy measures needed?

When it comes to today's monetary policy decision, it is a question of what it is possible to achieve, said Mr Ohlsson. It is possible to make monetary policy more expansionary. But at the same time, first of all there are signs that the impact of monetary policy has declined. Secondly, inflation should rise as resource utilisation increases. This has not happened to the extent that it has happened before. The question is whether the historical correlations between resource utilisation and inflation are no longer valid. Inflation has not risen to the same extent as resource utilisation. The correlation between resource utilisation and inflation was the subject of an article in the October Monetary Policy Report. This article presents the problems in a good way, but more work needs to be done on this subject.

Thirdly, the relationship between the exchange rate and inflation does not appear to be as straightforward as was previously assumed. Since the summer, the Swedish krona has weakened substantially at the same time as inflation has not risen to the same extent. The impact of the exchange rate on inflation is discussed in a useful way in an article in the draft Monetary Policy Report. However, according to Mr Ohlsson, there are a number of stones that remain to be turned in this context.

Another question is what it is desirable to do with monetary policy. Here one has to weigh up the advantages and disadvantages of different types of monetary policy. Weighed against monetary policy expansion, which appears to have a declining impact, are disadvantages that are becoming increasingly clear. For instance, asset prices are increasing rapidly in Sweden.

There are also increasing signs of a search for yield, economic agents are showing a loss aversion in the real world with negative interest rates. Some will succeed with their increased risk taking, while others will fail, said Mr Ohlsson.

We also see increased pressure on the pensions system when yields are pushed down. This is not merely concerned with monetary policy, the low global long-term interest rates also play a role. But as he said earlier, the long-term real interest rates appear to be increasing.

Finally, there is probably some monetary policy gunpowder left, but certainly not an unlimited amount. What remains should be saved for situations when the need is greater than it is now, according to Mr Ohlsson.

Mr Ohlsson wondered whether more expansionary monetary policy was really the solution to the problem that inflation is half a percentage point below the target. Even without cutting the repo rate and with an extension of the asset purchases, Mr Ohlsson felt that monetary policy would contribute to a rising inflation rate. It is not possible to disregard the fact that the repo rate is already at –0.50 per cent and the bond purchases amount to SEK 245 billion.

Mr Ohlsson's monetary policy conclusions were that the repo rate should be held unchanged and that the bond purchases should not be extended. On the other hand, he considered that the maturities and coupon payments on the government bond portfolio in 2017 should be reinvested the same year. With regard to the repo-rate path, he felt that it should continue to be formulated so that increases in the repo rate will begin in early 2018. The difference between the current repo-rate level and the minimum of the repo-rate path is interpreted by many to be a measure of the probability of a future cut in the repo rate. Here, Mr Ohlsson felt that the repo-rate path should be formulated so that this probability is now lower than at the October meeting and at the same level as at the September meeting. However, he explained that he did not intend to enter a reservation on this point.

Deputy Governor **Martin Flodén** began by pointing out, with regard to Mr Ohlsson's comments, that the monetary policy conducted in Sweden in recent years was not in his opinion a short-term endeavour to bring inflation to exactly 2 per cent. The Riksbank's monetary policy must be seen in the light of inflation being clearly below the target over a long period of time and that confidence in the target and the credibility of monetary policy has been threatened. As Mr Ingves pointed out, CPIF inflation has not attained the 2 per cent target since 2010. Perhaps a more important measure is the CPIF excluding energy. This measure of underlying inflation has not attained 2 per cent since the end of 2009. According to the various measures of inflation, the inflation rate has been on average around 1 percentage point below target for the past seven years. Mr Flodén emphasised that it was therefore not a question of a short-term search for tenths in the development of inflation, but of safeguarding the credibility of the inflation target.

He then went on to discuss developments following the last monetary policy meeting. At that meeting, at the end of October, there were two months filled with important political and economic events before us. None of these events has so far overturned the Riksbank's forecasts for the coming years, but the outcome of the US presidential election makes the development of the world economy in the long run appear more uncertain.

Internationally, long-term interest rates have risen since the Riksbank's most recent monetary policy meeting. This applies primarily in the United States, where rising inflation expectations appear to lie behind a large part of the upturn. Mr Flodén thinks it is interesting that the discussion in many circles now concerns the risk that inflation will become too high rather than that we will be stuck in a low-inflation trap. The discussion has some relevance for the Riksbank's monetary policy when one sees signs that it is also spreading to Sweden, as it can affect inflation expectations and thereby price setting and wage formation. Here, some have previously said that the low inflation environment is an unavoidable consequence of digitalisation and technological advances. Next year, we will see clearly higher inflation abroad when the effects of the earlier oil price fall wane. Mr Flodén believes that this, combined with the rising long-term international inflation expectations, will reduce the risk of falling inflation expectations in Sweden.

Developments in Sweden in recent months have largely confirmed the picture in the October Monetary Policy Report, said Mr Flodén. The real economy looks somewhat stronger perhaps, while the underlying inflation rate has on the margin been a disappointment. The short-term inflation expectations shown in Prospera’s survey have continued to rise, while the five-year expectations remain at a higher level than a few years ago. At the same time, the implied inflation expectations that follow from market pricing of nominal and real government bonds have risen clearly on all maturities. These inflation expectations, combined with the increasingly high resource utilisation, mean that the conditions for an inflation upturn in the coming years are good.

Moreover, the krona has been surprisingly weak over the past six months and particularly since the previous monetary policy meeting. The krona depreciation will probably reinforce the inflation upturn during the coming year. And even if the krona were to strengthen somewhat from the current levels, the development of the exchange rate will hardly prevent the inflation upturn from continuing, according to Mr Flodén.

Mr Flodén then went on to discuss the monetary policy considerations. The Riksbank indicated at the monetary policy meeting in October that there was a high probability of the repo rate being cut at today’s meeting, and moreover that the purchases of government bonds would continue in 2017. Mr Flodén argued at that meeting that the repo-rate path implied an excessively high probability of a repo-rate cut, and he thinks the proposed repo-rate path today also implies a too high probability of future rate cuts. He also wanted to clarify that he has not been close to advocating a repo-rate cut at today’s meeting.

The decision regarding government bond purchases was, however, not as self-evident to Mr Flodén, who pointed out that there are arguments both in favour of concluding the purchases and for continuing them. Arguments against a continuation included the strong development of the Swedish economy, combined with higher inflation expectations. This development contributes to inflation probably rising in the long run, even if some setbacks were to arise along the way. Another factor against a continuation is that the Riksbank has now purchased a significant share of the outstanding stock of nominal government bonds. This probably means that the monetary policy impact of further purchases will be smaller. One indication of this is the large use of the Swedish National Debt Office's repo facility and that the shortest market rates on government securities have been pushed down to the floor that the facility places 40 points below the repo rate.

The fact that the Riksbank's purchases have functioned well so far and probably been an important contribution to the stronger inflation development we are now seeing argues in favour of continued purchases. Even if inflation and inflation expectations have risen, one must admit that the inflation upturn is still fragile, said Mr Flodén. It is important to safeguard the recent development, and it would be risky to entirely stop the bond purchases now.

Mr Flodén's overall assessment was that it was appropriate to decide at today’s meeting to continue the bond purchases, but that these should be made at a slower pace during the next six months than during autumn 2016. Moreover, he assessed that there was now greater potential to obtain the desired monetary policy impact by purchasing real bonds rather than nominal ones. Purchases of nominal government bonds, as he had already pointed out, could become less effective when the Riksbank already owns a large share of the bonds. On top of this come the reinvestments of a large repayment of nominal bonds falling due in August 2017. Mr Flodén's assessment is that the Riksbank’s purchases will be at an unnecessarily fast pace, and that the stock purchased will become unnecessarily large in spring 2017, if the reinvestment is spread over the whole of 2017 at the same time as deciding to make new purchases of nominal bonds. He explained that he was therefore unable to support the proposal at today's meeting to extend the purchases of nominal bonds by SEK 15 billion.

Mr Flodén instead proposed that the Riksbank should purchase real government bonds for SEK 15 billion during the first half of 2017 and moreover, as in the proposed monetary policy decision, spread the reinvestment of maturities of the nominal bonds to be repaid at almost SEK 30 billion in August over the whole of 2017. This would entail a clear and appropriate tapering of the purchases during the next six months in relation to the purchases during the previous six months.

Mr Flodén said that the monetary policy he advocates would probably be perceived as somewhat stricter than the market's current expectations of the monetary policy decision at today's meeting. He assessed that such a decision, compared with the proposed decision in the draft Monetary Policy Report, would still not entail any major change in the pricing on the financial markets or for confidence in the inflation target in general.

To summarise, he explained that he thus does not support the proposal to extend the purchases of nominal government bonds. However, he supported the other proposals, that is to hold the repo rate unchanged at –0.50 per cent, to extend the purchases of real government bonds in the amount of SEK 15 billion, the plan to distribute the reinvestments of coupons and maturities, and the economic forecasts and draft Monetary Policy Report.

Governor **Stefan Ingves** then summarised the discussion. He noted that the Executive Board agreed on the picture of economic developments in Sweden and abroad, and the outlook for inflation described in the draft Monetary Policy Report.

Since the previous monetary policy meeting in October, the economic outlook abroad has brightened somewhat. However, developments ahead are fraught with uncertainty, which is noted in different ways during the meeting and was also made clear in the account of questions discussed during the drafting process.

In Sweden, the Riksbank's monetary policy, with a negative repo rate and purchases of government bonds, has contributed to a high level of growth, falling unemployment, higher inflation and rising inflation expectations, not least in the longer run where inflation expectations are now close to 2 per cent. The strong economic activity means there are good conditions for inflation to continue rising. It is expected to reach 2 per cent in the middle of 2018, more or less regardless of which measure of inflation one uses.

But there are still risks that can jeopardise the upturn in inflation. The outcomes for inflation have been lower than expected in recent months and this illustrates the uncertainty over how quickly inflation will rise. It is difficult to know, for instance, how the krona exchange rate will develop in an environment where the ECB has extended its asset purchase programme and the Federal Reserve has raised its policy rate. A slow appreciation is expected going forward, and it is important to the upturn in inflation that this appreciation is slow.

All of the Executive Board members assessed that it was now appropriate to hold the repo rate unchanged at –0.50 per cent and to reinvest maturities and coupon payments on the government bond portfolio until further notice. During 2017 these are unevenly distributed over the year, so the reinvestments should be spread out. The discussions also concerned the repo-rate path, but there were only very slight differences in the members' opinions and all supported the proposed repo-rate path in the draft Monetary Policy Report. Increases in the repo rate are not expected to begin until the start of 2018.

Moreover, a majority of the Executive Board members considered that the risks to the upturn in inflation call for a continuation of the government bond purchases during the first half of 2017 and that they should be extended by SEK 30 billion, corresponding to SEK 15 billion in nominal bonds and SEK 15 billion in real bonds.

Three members entered reservations, with slightly different motives, against the decision to extend the government bond purchases by SEK 30 billion.

Also discussed at the meeting, as on several previous occasions, were the risks linked to low interest rates over a long period of time and the risks linked to inflation undershooting the target over a long period of time. As on previous occasions, several members of the Executive Board expressed continued concern over the growing household indebtedness and emphasised the need to combine measures in different policy areas to attain a long-term sustainable development of the Swedish economy.

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

The Executive Board decided

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

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

§4. Decision to purchase government bonds

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

Deputy Governors Martin Flodén, Henry Ohlsson and Cecilia Skingsley entered reservations against the decision to extend the purchases of government bonds by SEK 30 billion. Mr Flodén advocated that the purchases should be extended by SEK 15 billion and only cover real government bonds. Mr Ohlsson and Ms Skingsley felt that the purchases should not be extended as monetary policy does not need to be made more expansionary in the current economic situation.

§5. Other decisions

The Executive Board decided

• to publish the Monetary Policy Report and decisions under Sections 3 and 4 at 9.30 a.m. on Wednesday 21 December 2016 with the motivation and wording contained in a press release, and

• to publish the minutes of today's meeting on Thursday 12 January 2017 at 9.30 a.m.

Sections 3 - 5 were verified immediately.

Minutes taken by

Sophie Brauner

Verified by:

Stefan Ingves Martin Flodén Per Jansson

Kerstin af Jochnick Henry Ohlsson Cecilia Skingsley

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