Monetary policy minutes

December 2017

SVERIGES RIKSBANK

Summary

At the Monetary Policy Meeting on 19 December 2017, the Executive Board of the Riksbank decided to hold the repo rate unchanged at -0.50 per cent. It is expected that rate rises will begin at a slow pace in mid-2018, which is the same assessment as made at the meeting in October. The Executive Board has also decided to begin reinvestment of the bonds that mature in 2019 during January 2018.

The Executive Board noted that the Riksbank's overall assessment of the economic outlook and inflation prospects in the years ahead remains the same as in the forecast in October.

Economic activity abroad is increasingly strong but global inflationary pressures are subdued and the normalisation of monetary policy abroad is expected to proceed slowly. In Sweden, economic activity is still strong and resource utilisation is higher than normal. CPIF inflation is close to 2 per cent, as are inflation expectations.

Several board members noted that although CPIF inflation is 2 per cent, it has taken time and required a great deal of support from monetary policy to achieve this. In order for inflation to remain close to 2 per cent going forward, monetary policy needs to continue to be expansionary. It is therefore too early to change the direction of monetary policy.

The Executive Board unanimously agreed to leave the repo rate unchanged at –0.50 per cent, with some slight differences in opinion regarding the appropriate time to initiate slow rate rises. Views also differed as regards the need to bring forward reinvestments of maturing government bonds. Large maturities, amounting to a good SEK 50 billion, will occur during the first half of 2019. In addition, there are coupon payments of a total of around SEK 15 billion from January 2018 to June 2019. A majority of the Executive Board considers it appropriate to initiate reinvestments of these maturities and coupon payments as early as January 2018 and to allow them to continue until the middle of 2019. This means that the Riksbank's holdings of government bonds will increase temporarily in 2018 and the beginning of 2019. Two members instead considered it more appropriate to wait and decide at a later stage whether, and if so how, redemptions during 2019 shall be reinvested.

Several members discussed aspects of the normalisation of monetary policy and how much monetary policy room for manoeuvre the Riksbank has in relation to central banks abroad. In this context, it was pointed out that the development of the exchange rate is particularly important.

Developments on the Swedish housing market were also discussed. The increase in housing supply and slowdown in housing prices are welcome developments. Although there are risks associated with the developments on the housing market, it was also noted that the strong economic activity in Sweden and abroad indicates only a rather moderate fall in housing prices.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No.6

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 787 00 00
Fax +46 8 21 05 31
registratorn@riksbank.se
www.riksbank.se

DATE: 19/12/2017

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

Carl-Johan Belfrage
Claes Berg
Emma Brattström (§ 1-3A)
Charlotta Edler
Heidi Elmér
Lena Eriksson
Mattias Erlandsson
Kerstin Hallsten
Jesper Hansson
Jens Iversen
Jesper Johansson
Ola Melander
Pernilla Meyersson
Ann-Leena Mikiver
Bengt Petersson
Maria Sjödin
Ulf Söderström
Fredrik Wallin (§ 1-3A)

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

§1. Economic developments

Emma Brattström from the Markets Department began by presenting the latest developments on the financial markets. Since the monetary policy meeting in October, monetary policy expectations have risen slightly in the United States, where the Federal Reserve revised up its forecast for GDP growth in conjunction with its latest monetary policy meeting in December. The stock market in the US has continued to rise rapidly as a result of increased expectations that the administration's proposed tax cuts will receive the support of Congress and due to the economy continuing to develop well. In the euro area, monetary policy expectations are unchanged. The European Central Bank (ECB) revised up the forecast for GDP growth in conjunction with its monetary policy meeting in December, but inflation is still low and government bond yields have fallen. Norges Bank revised up its policy rate forecast path at its monetary policy meeting in December. In Sweden, monetary policy expectations have been revised down marginally and government bond yields have fallen. The Swedish krona has depreciated as a result of the relatively low inflation outcome for October, the lower-than-expected GDP outcome for the third quarter and concern for developments on the housing market with falling housing prices.

Prior to today's monetary policy decision, it is assumed that the repo rate will be left unchanged. In their forecasts, several Swedish banks have postponed the timing for a first rate rise by the Riksbank.

Jesper Hansson, 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 Executive Board members. The monetary policy drafting process has included discussions with the Executive Board regarding the forecasts and the monetary policy assumptions at meetings on 8, 11 and 15 December. The draft Monetary Policy Report was discussed and tabled at a meeting with the Executive Board on 14 December.

Mr Hansson then summarised the new information received since the Monetary Policy Report in October. Third-quarter GDP growth in the US and the euro area was higher than expected in the forecast in the monetary policy report in October and, in the euro area, most growth indicators have been strengthened for the coming quarters. In Sweden, the GDP outcome for the third quarter was 3 per cent in annualised terms, slightly weaker than was expected in the Monetary Policy Report in October. Demand increased more or less in line with the forecast, but imports were surprisingly strong. Growth indicators point to continued strong development in the Swedish economy and the GDP forecast for 2018 in the draft Monetary Policy Report is unchanged at 2.9 per cent. Average housing prices fell by five per cent in total during the three months up to and including November. The krona exchange rate has been weaker than was expected in the Monetary Policy Report in October, but is expected in the longer term to strengthen to about the same level as in the assessment in October. Two new inflation outcomes have been published since the Monetary Policy Report in October. CPIF inflation for October of

1.8 per cent was slightly lower than was expected in the report in October, while the outcome for November, at 2.0 per cent, was slightly higher than expected. Excluding energy, CPIF inflation was only marginally higher than expected.

The recovery abroad continues and the forecast for GDP growth for Sweden's most important export markets, the KIX countries, is slightly revised upwards compared with the forecast in the Monetary Policy Report in October. This is due to the recently published, strong GDP outcomes and short-term indicators, not least in the euro area. Despite favourable growth in demand, inflationary pressures are relatively low and inflation is deemed to only rise slowly in the period ahead. Compared with the Monetary Policy Report in October, the inflation forecast for the KIX countries has been revised up slightly in the short run, due mostly to a higher oil price. In October, the ECB decided to prolong its net purchases of assets until at least September 2018. In accordance with market expectations, the Federal Reserve raised its policy rate by 0.25 percentage points at its monetary policy meeting in December and presented forecasts with further policy rate rises in 2018. In the draft Monetary Policy Report, monetary policy abroad is largely expected to be expansionary with only cautious policy rate increased in the years ahead.

Growth in the Swedish economy is high and, according to the draft Monetary Policy Report, expected to remain so some way into 2018, before slowing when new housing construction decreases and growth on export markets is subdued. The robust GDP growth has occurred at the same time as employment has increased substantially. The signs of a tight labour market are becoming increasingly clear. Companies are reporting major labour shortages and recruitment times are long. In the draft Monetary Policy Report, therefore, unemployment is expected to fall only slightly further to 6.5 per cent in 2018. Inflation measured in terms of the CPIF is expected to stabilise around 2 per cent. Higher resource utilisation both in Sweden and abroad will contribute to higher inflation while the appreciation of the krona, predicted in the forecast, will help to subdue price growth. Compared to the Monetary Policy Report in October, the forecast for inflation has been revised up for 2018 as a result of the weakening in the krona and higher oil prices.

The forecasts in the Monetary Policy Report are based on the monetary policy that is expected to gain a majority at today's monetary policy meeting. This involves the repo rate being left unchanged at –0.50 per cent. The repo rate is expected to stay at this level until mid-2018, after which a period of slow rate rises will be initiated. At the end of the year, the Riksbank will have purchased government bonds with a nominal value of SEK 290 billion. The forecast presupposes the reinvestment of redemptions and coupon payments at an even rate going forward. Major redemptions will occur in 2019 and, in order to maintain the Riksbank's presence in the market, reinvestment will begin in January 2018. The purchasing rate will then decrease from about SEK 1.5 billion per week during the second half of 2017 to about SEK 1 billion per week in 2018 up to the end of June 2019.

The most important issues during the drafting process that has preceded today's monetary policy meeting have been developments on the housing market and the strategy for normalising monetary policy.

Due to the recent decline in housing prices, a closer analysis of developments on the housing market has been performed. Housing prices have fallen three months running, although sales are comparatively stable. The assessment in the draft Monetary Policy Report is that the strong economic activity will result in continued strong demand for housing, which, together with a slowdown in housing construction, means that the decline in prices will be moderate. Housing investment is predicted to fall during the forecast period and has been revised down compared with the assessment in October. The spillover effects of falling housing prices to other parts of the economy are expected in the forecast to be minor.

With strong economic activity and inflation close to target, monetary policy is expected to be less expansionary in the period ahead. This brings to the fore the issue of how repo rate rises will be coordinated with the Riksbank's holdings of government bonds. An article in the draft Monetary Policy Report presents the Riksbank's overall strategy for monetary policy normalisation, which is similar to that chosen by other central banks. Firstly, net bond purchases are concluded, but redemptions and coupon payments continue to be reinvested. Thereafter, the repo rate is slowly increased. Once the repo rate has been raised to an appropriate level, reinvestment can be scaled back or concluded entirely so that bond holdings decrease. A specific circumstance for the Riksbank is that there is only a small number of government bond issues in Sweden, which means that redemptions occur in large steps. Reinvestment therefore needs to be spread out around the time the redemptions occur and they can also be brought forward as described in the draft Monetary Policy Report. The rate at which monetary policy needs to be tightened is of course uncertain and it may even need to be made more expansionary again. Exactly how monetary policy will be normalised depends on how the economy develops.

§2. The economic situation and monetary policy

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

The Swedish economy is continuing to strengthen in line with the Riksbank's last forecast. One uncertainty factor in the monetary policy decision in October was the extent to which the European Central Bank (ECB) would continue with its expansionary monetary policy and to which extent this could affect the Riksbank's room for manoeuvre in monetary policy. The background, as Ms Skingsley has previously described, is that stimulus among Sweden's trading partners is certainly also favourable for the Swedish economy but that excessively wide divergences in monetary policy could also cause a disadvantageous appreciation of the krona. By the day's meeting, it had become clear that the ECB aims to continue to conduct a monetary policy in line with the Riksbank's October forecast and it was good to have this information when assessing the situation, she noted. The strength of economic activity in Sweden and inflation close to target will certainly increase the Riksbank's scope for diverging from the ECB's policy, according to Ms Skingsley. At the same time, caution will also be needed in the period ahead, so that interest rate differentials will not cause an exchange rate movement that will be problematic for fulfilment of the inflation target.

Ms Skingsley then moved on to comment on the downward revision of housing investment in the draft Monetary Policy Report. For a number of years, the supply of housing has been on the low side in relation to demand and has therefore contributed to the heavy price rises on the housing market. Ms Skingsley therefore sees the sometimes surprisingly strong increase in housing construction in recent years as a welcome change. This increased supply is now restraining price rises and it would probably have been strange if an increased supply had not had this effect sooner or later. Naturally enough, this increased supply is also dampening households' expectations of continued price rises.

It is also understandable that the turnaround in housing prices is contributing to a certain slowdown in housing investment, Ms Skingsley continued. She went on to explain that she expects that the uncertainty over housing prices and housing investments will persist for a while yet and have a restraining effect on growth, in accordance with the forecast in the draft Monetary Policy Report. At the same time, she notes that economic activity remains strong and that housing requirements in Sweden argue for further housing investment. However, it is possible that this investment will be more prolonged than previously assumed.

Otherwise, the forecast holds up as a whole, observed Ms Skingsley, and went over to the matter of appropriate monetary policy. Ms Skingsley explained her support for holding the repo rate and repo rate path unchanged. As regards bond purchases and the management of the bond portfolio, she wished first to remind the meeting that she entered a reservation against the new investment in government bonds decided since the second six months of 2016. This was due to her assessment that monetary policy did not need to become more expansionary and that she had had a certain amount of patience with subsequent forecast disappointments.[1]

Considering the strong development of the macroeconomy, including inflation close to the 2 per cent target, Ms Skingsley currently sees no argument for purchasing further bonds with the aim of increasing the expansiveness of monetary policy. However, questions remain over how the portfolio of government securities already purchased should be managed.

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[1] A longer discussion on further purchases of bonds can be found in "A year of negative interest rates. Where do we stand?", speech by Cecilia Skingsley at Danske Bank, 7 April 2016.

Various alternative courses of action for the management of this portfolio can be imagined, Ms Skingsley continued. One alternative would be to declare at the day's meeting that purchased bonds will be allowed to mature without the funds received being reinvested, so that the portfolio would thereby be allowed to shrink apace with maturities. According to Ms Skingsley, such an approach at present would be perceived as a commitment to make monetary policy less expansionary as the bonds matured. Considering that it has taken such a long time and needed so much monetary policy expansion to return inflation to target, this alternative would be far too risky. A more gradual adjustment of monetary policy's degree of expansiveness would be preferable, according to Ms Skingsley.

The next alternative is to not take a stance on the possibility of reinvesting until maturity is approaching, Ms Skingsley continued. That alternative would retain the expansiveness of current monetary policy and, at the same time, maintain flexibility regarding which choice would be best as maturity approaches. This is an alternative that Ms Skingsley finds attractive. No bonds in the Riksbank's portfolio will mature in 2018, but significant maturities of SEK 50 billion are to be expected in the first six months of 2019. However, future maturities will have to be managed in an environment in which there remains a need to watch out for any disadvantageous exchange rate effects of the ECB's continued expansionary efforts and where Swedish inflation expectations will remain impressed by the long period of low inflation.

Growing indications that the functioning of the government securities market is becoming impaired can be added to this, according to Ms Skingsley. She considers that clearly answering how well the government securities market functions, and to which extent it will be affected by the Riksbank's bond purchases, are difficult tasks. Similarly, there are indications that she does not wish to disregard. For example, investors report difficulties in making large portfolio adjustments. Tendencies towards the divergence of indicative prices and actual final prices are another sign that the functioning of the market has deteriorated. Being an investor but being unable to adjust holdings effectively is a deterrent towards future market presence. Ultimately, market rates could rise when any Riksbank bond purchases take place, which would be in opposition to the Riksbank's intentions. Long-term uncertainty over how the Riksbank manages approaching maturities could risk impairing the functioning of the market.

To contribute towards making the government security market more predictable, Ms Skingsley's conclusion is therefore that a decision should be taken today on the reinvestment of maturities over the first six months of 2019 and the evening out of these over the coming 18 months. Seen over the entire forecast period, the monetary policy expansiveness would be approximately the same as in the alternative of waiting with any reinvestment decision.

As regards later maturities, it remains an open question for Ms Skingsley as to whether these should be reinvested or not. In her opinion, an appropriate approach would be for repo rate increases to have been under way for a while before starting to wind up the portfolio becomes an issue. The repo rate would then become the prime instrument as and when the Riksbank needs to adjust monetary policy.

First Deputy Governor **Kerstin af Jochnick** began by supporting the assessments and forecasts made in the draft Monetary Policy Report and by explaining that she supports the proposal to hold the repo rate and the repo rate path unchanged. Furthermore, she said that there are good reasons to start, as early as 2018, the reinvestments of the large maturities of government bonds falling due in early 2019.

As regards global development, economic activity is continuing to strengthen in both the euro area and the United States. The global trade in goods has continued to increase at a good pace and the global index for export orders is providing good conditions for a continued positive trend in trade. As far as the euro area is concerned, growth looks likely to become slightly stronger than the Riksbank had previously estimated. One open question is whether the forecast might possibly underestimate the recovery of the euro area. Confidence among households and companies now seems to be on high levels and growth is rising broadly across many countries and sectors. To this can be added increasing optimism and political unity over strengthening the monetary union. The situation for deepening the monetary union is strategically advantageous as economic activity becomes better and better. The ongoing negotiations between the European Union and United Kingdom on Brexit will probably also strengthen the euro area as many companies that have so far been based in the United Kingdom are now also setting up in the euro area. However, the development of underlying inflation in the euro area continues to be weak and the European Central Bank is expected to conduct a highly expansionary monetary policy in the next few years.

Developments in the United States continue to look good and the proposed tax reform will probably lead to a small and temporary increase in growth. The growth forecast has been revised slightly upwards for this year and next year. Underlying inflationary pressures have been fairly low, among other reasons due to moderate wage growth in relation to the low level of unemployment. However, the continued rise in resource utilisation is contributing towards inflation being expected to increase in the period ahead. Global inflationary pressures thus continue to be fairly weak. The normalisation of monetary policy abroad is progressing at a slow rate. At the same time, it is important to note that the major central banks are in different monetary policy phases, according to Ms af Jochnick. This is clearly illustrated by the manner in which the implied forward rate path changed over the autumn. In the United States, the forward rate path has shifted upwards slightly since October. In the euro area, in contrast, the forward rate path is largely unchanged, which implies that the policy rate cannot be expected to be raised until some point in 2019. The ECB’s clear communication of an unchanged policy rate for a long time to come is an important explanation of this. The gap between US and European interest rates will widen over 2018 as the Federal Reserve is expected to carry out more interest rate rises. It is reasonable for the foreign exchange market and the krona exchange rate to be affected by the differences in monetary policy. This could also form part of the explanation for the depreciation of the krona over the autumn.

Developments in Sweden are closely following the forecasts that the Riksbank presented in the autumn, Ms af Jochnick continued. The forecast for economic activity in Sweden remains largely unchanged. But housing investments are expected to be slightly lower than in the previous forecast due to the decline of housing prices. However, the effects on GDP growth will be partly counteracted by stronger demand from abroad. Growth is expected to be somewhat lower than in the previous forecast, but economic activity will continue to be strong and resource utilisation will be higher than normal over the forecast period. The latest survey from Prospera shows that inflation expectations decreased marginally among money market participants. However, since 2014, inflation expectations have risen over both the short and long terms and are close to 2 per cent for both the CPI and CPIF. Since 2014, inflation has also risen. In November, CPIF inflation amounted to 2.0 per cent. The favourable development of inflation expectations and inflation is due to monetary policy having been highly expansionary, Ms af Jochnick pointed out. The Riksbank safeguards the role of the inflation target as anchor for price setting and wage formation. Continuing the expansionary monetary policy according to the forecast is expected to mean that inflation remains stable at close to 2 per cent during the forecast period.

In general, uncertainty will persist due to factors in international developments that the Riksbank has previously indicated. These include geopolitical uncertainty abroad, the consequences of Brexit and the vulnerability of the European banking system. When it comes to the Swedish economy, the housing market is now a more obvious risk factor than previously, according to Ms af Jochnick.

As the Riksbank has highlighted the problems in the housing market for several years, the more general understanding that the development of housing prices and indebtedness has not been sustainable over the long term is welcome, Ms af Jochnick said. The price falls that have taken place so far are not surprising and the need for structural changes on the housing market continues to be great. In its latest Financial Stability Report, the Riksbank pointed out the need for measures concerning both regulation and taxes.

Consequently, the dampening of price growth alone is not sufficient, Ms af Jochnick continued. Over the long term, what is needed is measures to create an efficient housing market in which supply and demand match each other better than they do at present. There is a risk that problems on the housing market will spill over to the financial system. A not insignificant share of housing funding takes place through covered bonds in foreign currency. Consequently, confidence in the housing market or the banking system must not be damaged. With a well functioning housing market, better conditions would be created for the more stable development of the Swedish economy. This would reduce the vulnerability to society formed by high indebtedness in the housing sector.

All in all, Ms af Jochnick made the assessment that the development of the macroeconomy since the monetary policy meeting in October does not justify a change in monetary policy. As regards the reinvestments of the bonds to mature in 2019, she considers that there are several reasons to divide up the repurchases over a longer period. Even if the Riksbank considers that the government bond market is functioning well, there may arise risks as regards, for instance liquidity on the market. Considering the large maturities falling due in 2019, it does not seem reasonable to hold off repurchasing until they have taken place. Initiating repurchases as early as January 2018 will allow them to be spread out over a longer period. The Riksbank will thus maintain its presence in the government bond market. Participants on the market will thereby know that the Riksbank will hold regular auctions at an even pace over 18 months.

Deputy Governor **Per Jansson** began by saying that two new outcomes for inflation and inflation expectations have been published since the monetary policy meeting in October. The most recent inflation outcome, for November, reported a CPIF inflation rate of 2.0 per cent. In the Monetary Policy Report in October, it was assumed that the outcome would be 1.7 per cent. The fact that inflation was exactly in line with target is of course pleasing, especially since the forecast was for it to fall back and be quite clearly below 2 per cent. It should, however, be noted that the upside surprise was almost entirely due to a faster-than-anticipated rise in energy prices. Adjusted for energy prices, the outcome amounted to just under 1.8 per cent, which was only marginally higher than forecast in October.

Mr Jansson noted that the new outcomes for inflation expectations, from Prospera's monthly survey in November and quarterly survey in December, fell, with the odd exception, for all respondents and time horizons, which was a downside surprise. It is possible that the relatively large fall in inflation between September and October, from 2.3 to 1.8 per cent, played a part in this. Neither can it be ruled out that the recent, rather sharp slowdown in housing prices may have had an effect. Overall, however, expectations are still close to the inflation target. And, as regards expectations of inflation two and five years ahead, the fall has, in most cases, actually led to slightly smaller deviations from the target than previously.

The development of inflation expectations going forward is of crucial significance for the Riksbank's scope for keeping inflation close to 2 per cent. The importance of individual outcomes should of course not be overstated. But if expectations were to continue to fall as broadly and as much as has now occurred, it would sooner or later matter for monetary policy, he stated. This is something Mr Jansson said he would take with him as an important issue to the monetary policy discussions in the spring.

Despite the unwelcome downturn in inflation expectations, it is difficult to come to any conclusion other than that the current picture for inflation continues to be rather bright. This is positive, of course, but it is also a question of it continuing to be so, Mr Jansson emphasised. This led him to focus on the forecast for inflation.

The forecast adjustments proposed in the draft Monetary Policy Report are overall rather small. The assessment for CPIF inflation excluding energy prices is more or less unchanged. Admittedly, the krona exchange rate has developed weaker than expected since October and this is pushing up the forecast for imported inflation. But the effects are counteracted by the fact that GDP growth is now assumed to be slower than before. Just as in October, inflation excluding energy prices is expected to stabilise close to 2 per cent towards the end of next year. Higher energy prices mean that the forecast for CPIF inflation has been adjusted upwards slightly over the coming year. An important difference compared with the October report is therefore that inflation in the near term is no longer expected to fall back but to remain close to 2 per cent for the entire forecast period, he observed.

In the draft Monetary Policy Report, it is assumed that target attainment for inflation in the coming years will be good even if the Riksbank does not now prolong its net asset purchases and delays the timing of an initial repo rate increase, Mr Jansson continued. As before, he harboured quite considerable doubt as to whether it will be possible to combine such a monetary policy with an inflation rate that remains close to target. Mr Jansson nevertheless chose to support both the forecast and the monetary policy in the draft Monetary Policy Report. He said that he would explain his reasoning behind this choice in a minute.

Firstly, however, Mr Jansson wished to briefly summarise the most important reasons why there could be a need for a more expansionary Swedish monetary policy in the current situation. Sweden is a small, open economy with significant trade with other countries, primarily the rest of Europe. If the economic situation improves in these countries, the Swedish economy will also improve. And the converse is true, of course, if the economic situation abroad deteriorates. As regards the linkage to monetary policy in the euro area, the Riksbank is naturally not obliged to slavishly follow every movement that occurs there. But if there is major divergence, the effects on the krona exchange rate can be difficult to manage, he stressed.

The current subject of discussion is how the Riksbank should conduct its monetary policy so that the krona exchange rate strengthens slowly and in an orderly fashion in the years to come. To achieve this, normalisation of Swedish monetary policy must not start too early. The ECB announced in October that net asset purchases are intended to continue until the end of September 2018, or beyond, if necessary, and in any case until the inflation path has been adjusted in a sustainable way towards the inflation aim. At the same time, it was announced that the purchasing rate per month is expected to be reduced from 60 to 30 billion euros after the turn of the year. The ECB has also communicated that its policy rates are expected to remain at present levels for an extended period of time, and well past the horizon of the net asset purchases. Mr Jansson’s conclusion was that the ECB thus is continuing to make its monetary policy more expansionary, both by prolonging its net asset purchases and reiterating that a rate rise will only occur long after these purchases have ceased.

What the ECB means by “long after” is of course not easy to know, but it can in any case be noted that many economists and market participants are of the opinion that an initial rate rise will not occur until around mid-2019.[2] It can be of interest in this context to point out that the forecast for HICP inflation in the euro area in the draft Monetary Policy Report is 1.5 per cent for 2019 and 1.7 per cent for 2020. Whether this means that the inflation path has been adjusted in a sustainable way towards the inflation aim, in line with the thinking of the ECB, can certainly be discussed, he reasoned.

In order to try to understand what “long after” means, comparisons can also be drawn with other central banks that have already concluded their net purchases and started to increase the policy rate. The Federal Reserve made its last asset purchase in October 2014 and began raising the interest rate in December 2015. The Bank of England concluded its purchases in January 2017 and raised the policy rate for the first time in November 2017.[3] Mr Jansson acknowledged that it is of course impossible to know whether the ECB will act in a similar fashion. But if this were to be the case, it means that the ECB’s first rate increase may not be until the end of 2019 or even the beginning of 2020.

These, he said, are strong arguments against not prolonging the net asset purchases and somewhat postponing the timing for a first increase of the repo rate. It is not a question of the Riksbank having to start normalising monetary policy at exactly the same time as the ECB. But doing so one year or perhaps more ahead of the ECB would quite clearly be a tough challenge for a small, open economy like Sweden.

How then does this reasoning concur with not entering a reservation against the monetary policy assumptions made in the draft Monetary Policy Report? The easiest and most straightforward way of prolonging the net asset purchases would certainly have been to just take the decision to continue to buy new assets. But that proposal is now expected not to receive the support of a majority of the Executive Board. A proposal that is expected to receive the support of a majority, however, is to bring forward reinvestment of redemptions and coupon payments so that these start as early as January next year. During the first half of 2019, there will be large redemptions amounting to more than SEK 50 billion. Furthermore, coupon payments totalling about SEK 15 billion will be received between January 2018 and June 2019. This total amount of about SEK 65 billion will be evenly and continuously reinvested during the period January 2018 to June 2019. This means that the Riksbank’s holdings of government bonds will continue to increase throughout 2018 and into early 2019. Hence, this proposal will also lead to monetary policy being more expansionary for a reasonably long period, even though it is of course not the same as

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[2]According to Bloomberg survey, 4-7 December.

[3] The complication that the Bank of England concluded its purchases for the first time in November 2012 and resumed them in August 2016, in the wake of the Brexit vote, is disregarded here.

prolonging net asset purchases with the intention of keeping the assets for a long time on the balance sheet. Against this backdrop, Mr Jansson was able nevertheless to support the proposal.

However, he found the proposal to keep the path of the repo rate completely unchanged a little more difficult to digest. If, like Mr Jansson, one considers an important aim of bringing forward reinvestments to be to make monetary policy more expansionary, then it is of course somewhat contradictory to continue to forecast that interest rate rises should start relatively soon after these investments have begun. Why would one wish to step on the accelerator and apply the brakes simultaneously, he asked himself. The problem could have been mitigated in part if the timing of an initial repo rate rise had been postponed slightly, perhaps until into the autumn of next year, and, if necessary, the pace of reinvestments had been adjusted so that monetary policy did not become too expansionary overall.

Despite these concerns and objections, Mr Jansson chose in this situation not to enter a reservation against the proposed repo rate path. When all is said and done, this is just a forecast of how the Executive Board will act and there will be opportunities during the spring to return to this issue on a number of occasions. By that time, there will also be more information available in order to assess whether the misgivings about normalising monetary policy too early are justified or not.

Deputy Governor **Martin Flodén** began by saying that he supports the proposal to hold the repo rate unchanged, as well as the proposed forecast in the draft Monetary Policy Report, including the forecast for which repo rate will be appropriate over the coming years. On the other hand, he did not support the proposal to immediately start reinvesting the government bonds to mature in 2019. He considered that it would have been more appropriate to continue reinvesting coupons and maturities on an ongoing basis as these fall due, and then to decide later on whether and how the large maturity of one bond in March 2019 and a smaller maturity in June 2019 should be reinvested.

Economic developments abroad have continued to strengthen since the monetary policy meeting in October. This applies in particular to the euro area, forecasts for which have been revised up over the entire forecast period in the draft Monetary Policy Report. However, price pressures continue to be moderate and the assessment of international inflationary pressures has not changed appreciably.

In Sweden, Mr Flodén continued, surprisingly high energy prices have led to CPIF inflation becoming higher than expected, but underlying inflation according to the CPIF excluding energy has developed in line with the forecast in the Monetary Policy Report from October. Ahead of the October meeting, there were signs that price rises on the housing market had come to a halt. Developments in recent months have confirmed that view and prices have now fallen slightly. The fact that prices have stopped rising after a long period of rapid increases may, of course, lead to a number of problems for individual participants and there is also a risk that such problems will give rise to a number of macroeconomic disturbances. But the subdued price increases are basically desirable, rather than problematic. And the Swedish economy is still strong. Apart from domestic factors, such as relatively high population growth, low interest rates and strong public finances, growth is now also being supported by improved economic activity abroad. The conditions are therefore good for the slowdown on the housing market to be soft and for housing investment to only fall moderately in the next few years.

On this basis, his assessment was that Sweden's economic outlook and inflation prospects are similar to those prevailing at the October meeting and that it would be appropriate to stick to the monetary policy plan formulated in October. For Mr Flodén, this means that a continued expansionary monetary policy is necessary to hold inflation around the target level in the period ahead. He therefore considered that it will be appropriate to hold the repo rate at –0.50 per cent until the middle of next year before initiating slow rises, as the repo rate forecast indicates in the draft Monetary Policy Report. Furthermore, for him, this meant that the additions to the holding of government bonds should be terminated when the present purchase programme expires at the end of the year, but that, until further notice, coupons and maturities should be reinvested in close connection to the occasions on which the Riksbank receives these funds.

So Mr Flodén did not consider that the Riksbank should start to reinvest the maturities that will fall due in 2019 as early as January. His resistance towards such a decision is based on several factors. Bringing reinvestments forward in the manner proposed in the draft Monetary Policy Report would mean a fairly marked increase in the holding of government bonds in 2018. As Per Jansson said in his contribution, bringing the maturity forward could therefore be seen as making monetary policy a little more expansionary than if the reinvestments were to be made later. This perspective gains strength when considering the limited borrowing requirement of the government and the Swedish National Debt Office's plans to only issue small volumes of new government securities in 2018. The remaining stock of government securities not owned by the Riksbank is therefore expected to decrease in 2018, even if reinvestments are not brought forward.

In addition, Mr Flodén did not see it as self-evident that it would be appropriate, at a later stage, to reinvest the large bond maturities to occur in 2019. In April, he opposed the decision to purchase government bonds in autumn 2017. The reasons for continued bond purchases have not strengthened since then. Resource utilisation is still high. Interest rates are low, access to credit is good and financial conditions are also good in general. The krona is not appreciating in a way that hampers a continued uptick in inflation. Inflation and inflation expectations have risen, implying stronger confidence in the inflation target. And, like previously, it is his assessment that continued asset purchases no longer make Swedish monetary policy noticeably more expansionary. The largest effect of the asset purchases has probably arisen through the yield on short-term government securities being pushed quite far below the repo rate. This effect will probably persist for some time to come, among other things due to the government's limited borrowing requirement, even if, after the turn of the year, the Riksbank were only to reinvest the coupon payments received in 2018. In addition, the fact that yields on government securities are already low in relation to the present and expected levels of the repo rate affects the cost-benefit analysis and means that risks to the future development of the Riksbank's balance sheet will increase with further bond purchases.

If purchases are initiated five or six quarters ahead of the maturities, as in the proposed Monetary Policy Report, Mr Flodén saw this rather as an extended purchase programme than a reinvestment of maturities in the Riksbank's holdings of bonds. He would have preferred to have delayed a decision on and implementation of any reinvestments of the bond maturities taking place in 2019 until a later point. Such a decision could then have been based partly on how interest rates and exchange rates had developed at the start of 2018 when the Riksbank's presence on the bond market had become smaller and partly on better knowledge about the date of the first repo rate rise.

In summary, Mr Flodén thus considered that the economic outlook in Sweden and abroad continues to be good and that conditions are also good for the highly expansionary monetary policy the Executive Board previously formulated to result in inflation holding close to two per cent over the next few years. He therefore advocated holding the repo rate constant at –0.50 per cent, keeping the same forecast for the development of the repo rate in the period ahead as at the monetary policy meeting in October, and, until further notice, the Riksbank reinvesting coupons and maturities in its holdings of bonds as they occur.

Governor **Stefan Ingves** began by saying that he shared the view of international developments and the Swedish economy presented in the draft Monetary Policy Report and that he supported the proposal for a monetary policy decision. This also applies to the proposal to bring forward the reinvestment of bond redemptions.

Mr Ingves further noted that the economic outlook and inflation prospects are roughly the same as at the previous monetary policy meeting in October and so an approximately unchanged monetary policy is also the most appropriate.

According to Mr Ingves, we have come a little closer to the point in time when monetary policy is expected to change direction, but we are not there yet. When a central bank approaches such a turning point, expectations and assessments of the market can be a little more sprawling than usual. Different events in the economy abroad or in Sweden can have a temporary but fairly large impact on expectations. The monetary policy temperature tends to rise in the media, too. However, temporary changes in direction in such assessments are scarcely a major problem at present, as the economic outlook and inflation prospects have not changed very much.

He went on to say that what is of central importance is that the inflation outcomes have been close to 2 per cent for a period of time and that the forecast implies inflation around 2 per cent for the whole of the forecast period. In addition, inflation expectations in the short and long run are close to 2 per cent.

Economic activity in Sweden is very good. This is partly because we are receiving help along the way from increasingly strong economic activity abroad. Both global trade and industrial production are growing and confidence in the future is high.

In the United States, consumption is supported by increasing employment and low unemployment. The confidence indicators are at high levels. The growth forecast has been revised upwards for this year and next year. Inflation is expected to rise going forward as a result of the continued rise in resource utilisation. In line with market expectations, the Federal Reserve raised its interval for the policy rate further last week and the gradual tapering of the balance sheet is continuing.

In the euro area, an increasing number of countries are now experiencing an upturn in economic activity. Strong global demand and a pent-up need for consumption and investment are reinforcing growth. Employment is rising. The household and corporate sectors are showing an increase in optimism. The growth forecast has been revised up. Inflation in the euro area is still fairly low, but is expected to attain 1.7 per cent towards the end of the forecast period. The ECB announced in October that its net asset purchases would be extended to September 2018 or longer, if necessary. The ECB decided to hold its policy rate unchanged last week. Market participants are expecting the first rate increase in 2019.

All in all, GDP growth in the countries that are most important for the Swedish economy (KIX-weighted) is expected to be on average just below 3 per cent in 2017 and 2018 and then gradually slow down. This is a slight upward revision, primarily due to stronger developments in the euro area.

Underlying inflation abroad is still low. However, the rising oil price has contributed to a certain increase in CPI inflation in recent months. The KIX-weighted inflation is expected to rise from just below 2 per cent in 2017 to just above 2 per cent towards the end of the forecast period.

The economic prospects for Sweden remain largely unchanged. The increasingly strong economic activity abroad is expected to partly counteract the cooling of the domestic housing market that has been noted over the past couple of months. Strong economic activity abroad and in Sweden indicates continuing good demand for housing. The decrease in housing prices is expected to be moderate, but to contribute to housing investment being lower than in the previous forecast. Despite somewhat lower growth than in the previous forecast, economic activity is strong, employment is high and resource utilisation is expected to be higher than normal during the forecast period.

Inflation in Sweden has shown a rising trend since 2014. A relatively broad upturn in services prices has played an important role in this development. Over the last year, rising energy prices have also contributed to the upturn. In November 2017, CPIF inflation amounted to 2.0 per cent. The forecast for the CPIF excluding energy remains largely unchanged. However, rising energy prices are contributing to the assumption that the CPIF will increase somewhat faster over the coming year than was assumed in the previous forecast. The monetary policy that is forecast and the strong economic activity will contribute to CPIF inflation remaining close to 2 per cent for the whole of the forecast period.

Stronger international economic activity and rising domestic resource utilisation mean, however, that the time to reduce the expansiveness of monetary policy has come closer, said Mr Ingves. But the question is when will be the right time to change direction. Domestic inflation and domestic inflation expectations are decisive but it is also important for a central bank in a small open economy to find a suitable balance or position in relation to monetary policy in the large currency areas. The Riksbank needs to consider the decisions made by the Federal Reserve and the ECB.

Mr Ingves reminded the meeting that the Riksbank had earlier said that if monetary policy in Sweden were to quickly become less expansionary and deviate from monetary policy abroad, the krona might risk appreciating too fast and contributing to inflation undershooting the target. He thinks that this conclusion still applies.

Now we know more about the monetary policy direction that the Federal Reserve and the ECB respectively consider to be most suitable, observed Mr Ingves. It is evident that the monetary policy turning point in the euro area will come considerably later than that in the United States. The Riksbank's forecast is based on the assumption that with regard to the development of resource utilisation and inflation in Sweden, it should be possible to begin raising the policy rate here before the ECB raises its rate. The Riksbank's recent assessments and forecasts still stand and indicate that this will be the case.

Mr Ingves then expressed his support for the proposal to hold the repo rate unchanged at –0.50 per cent and the forecast that the repo rate will remain at this level until mid-2018, when slow increases will be initiated. But during the period ahead, when the turning point comes closer, the Riksbank will as always be prepared to adapt according to the situation. So far, as Mr Ingves sees it, the situation remains unchanged with regard to what was previously communicated. Nor is it a single decision that is decisive for the direction of monetary policy.

As usual, there are risks that can change the forecast as to how monetary policy should be shaped in the future, continued Mr Ingves. The risks go both ways. The economic upturn abroad and the high level of domestic resource utilisation could, for instance, lead to higher wage increases and higher inflation than calculated. But developments abroad can also be more negative than forecast and dampen inflation further than expected. A third risk scenario is that the slowdown on the housing market will dampen resource utilisation more than expected. If the housing market slows down substantially, there is a risk that the krona will also weaken substantially, which could push up inflation and contribute to creating a monetary policy dilemma in the balance between resource utilisation and inflation. In such a scenario it is possible to find a suitable balance between the stabilisation of inflation around the target, which comes first, and stabilisation of the real economy a few years ahead.

The current programme for government bond purchases will continue until the end of 2017, and will then amount to SEK 290 billion. Redemptions and coupon payments will be reinvested until further notice. During the first half of 2019, there will be large redemptions amounting to more than SEK 50 billion. According to the proposal for a decision, these will be reinvested evenly during the period from January 2018 to June 2019 to retain a presence on the market and attain a relatively even rate of purchases. This means that the Riksbank's holdings of government bonds will increase temporarily in 2018. If it is assessed as appropriate further ahead, the redemptions in 2020 may also be reinvested. It is important to note that even if the current programme is concluded, it is not possible to rule out potential needs for future purchases of government bonds to safeguard the inflation target. A continued presence on the market is an advantage. In this way, flexibility is retained further ahead, and this is independent of whether the purchases are increased or reduced. Today's decision is in this respect a form of insurance, concluded Mr Ingves.

Deputy Governor **Henry Ohlsson** began by supporting the proposal to hold the repo rate unchanged at –0.5 per cent. However, he did not support the proposal to now bring forward reinvestments of maturities for government bonds.

The economic situation abroad is good, Mr Ohlsson continued. One expression of this is that global trade in goods is increasing. In recent months, this has also taken place at an increasing pace, which is of decisive significance for a small, open economy such as Sweden's. Annual growth abroad, KIX-weighted, is expected to amount to an average of around 2.5 per cent in the period ahead according to the forecast in the draft Monetary Policy Report. Inflationary pressures are indeed low, but aggregate KIX inflation is expected to be just above 2 per cent over the forecast period. This means that there are expectations of a less expansionary monetary policy abroad. The US central bank has recently raised its policy rate. According to the draft Monetary Policy Report, the KIX interest rate is expected to rise, albeit at a slow pace.

The annual rate of increase of the CPIF was 2.0 per cent in the most recent inflation reading from November. The corresponding reading for November 2016 was 1.6 per cent. CPIF inflation has been around the inflation target for some time, Mr Ohlsson pointed out. In the last eight months, CPIF inflation has been in the interval 1.8–2.4 per cent. According to the forecast in the draft Monetary Policy Report, inflation will be 2 per cent over the coming three years. Target attainment is good, noted Mr Ohlsson.

The December reading of five-year inflation expectations among participants on the money market had a mean value of 2.0 per cent. Over the last 24 months, the mean value of five-year expectations has been 1.9 per cent or higher. Looking at the median value, five-year expectations have been 1.9 per cent or higher for 26 months. The impression that inflation expectations are now back at the two-percent target is strengthened if we look at expectations two years ahead. In December, these were also at 2.0 per cent. Looking back, two-year expectations have been 1.9 per cent or higher for the last twelve months. Finally, one-year expectations in December were at 1.9 per cent or higher for the fourth month running. This is the first time this has happened since August–November 2011. It is difficult to argue that inflation expectations are not well-anchored now, said Mr Ohlsson.

According to the most recent labour force survey (LFS), unemployment was 5.8 per cent (not seasonally adjusted) in November. This is lower than the corresponding month one year earlier, when LFS unemployment was 6.2 per cent. Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. In November, the percentage of openly unemployed fund members was 2.4 per cent. It is also on the same level as the same month one year ago, when the proportion of unemployed insurance fund members was also 2.4 per cent. Mr Ohlsson concluded that unemployment appears to have bottomed out. The unemployment figures from earlier in the autumn also suggest this.

However, unemployment is still on too high a level, Mr Ohlsson said. But the question that should be asked, in his opinion, is: is it possible to reduce unemployment still further with general demand side policies? His assessment of the current situation is that the increasing demand for labour is causing labour supply to rise rather than unemployment to fall. General demand side policies seem to be approaching the end of the road when it comes to bringing unemployment down.

It is becoming increasingly clear that it is up to other policy areas to bring down unemployment, Mr Ohlsson continued. In such a situation, there are basically two ways of increasing demand for the part of the labour force that is without work: either we increase productivity among the unemployed by training them or we reduce the costs of employing them, for example via subsidies or lower payroll taxes, measures that it is realistic to believe can be implemented.

Against the backdrop of this reasoning, Mr Ohlsson presented his monetary policy considerations. Monetary policy cannot be guided by a few tenths above or below 2 per cent inflation. For every month that passes with inflation close to 2 per cent in outcomes and expectations, we come closer to the point at which monetary policy should start to be normalised, according to Mr Ohlsson.

It is being proposed today that the reinvestment of maturities for government bonds be brought forward almost 15 months ahead of actual maturity. According to Mr Ohlsson, what this is really about is a continued extension of the purchase programme. It could be called a reinvestment, but the difference from an extension is hard to see, he continued, pointing out that he considers an extension to be unwarranted and that he therefore intended to enter a reservation against such a decision.

Mr Ohlsson reminded everyone that, at a couple of previous meetings, he had expressed the opinion that the repo-rate path should be formulated to predict that repo rate rises would be initiated at the beginning of 2018. In light of what he said earlier in this statement, he is of the same opinion today. Very soon, it will be time to start normalising monetary policy, continued Mr Ohlsson, explaining that he is convinced that the Riksbank will return to this topic at the monetary policy meetings in February and April.

Mr Ohlsson then summarised his conclusions. He supported the proposal to hold the repo rate unchanged at –0.5 per cent. However, he did not support the proposal to now bring forward reinvestments of maturities for government bonds.

§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 on reinvestments of government bonds

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

Deputy Governors Martin Flodén and Henry Ohlsson entered reservations against the decision to begin reinvesting in January 2018 the bonds that mature in 2019. They advocated that the Executive Board should decide at a later stage whether and how the bonds maturing in 2019 should be reinvested.

§5. Decision on the Executive Board's meeting calendar 2018

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

§6. Other decisions

The Executive Board decided

• to publish the Monetary Policy Report and interest rate decision under Sections 3, 4 and 5 with the motivation and wording contained in a press release at 09.30 on Wednesday 20 December 2017, and

• to publish the minutes of today's meeting on Wednesday 10 January 2018 at 09.30.

This paragraph was verified immediately.

Minutes taken by

Lena Eriksson

Verified by:

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

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 - 787 00 00
Fax +46 8 - 21 05 31
registratorn@riksbank.se
www.riksbank.se