



Monetary policy minutes

July 2017

Summary

At the Monetary Policy Meeting on 3 July, the Executive Board of the Riksbank decided to hold the repo rate unchanged at -0.50 per cent. The first rate increase is not expected to be made until the middle of 2018, which is the same assessment as in April. The purchases of government bonds will continue during the second half of 2017, in line with the plan decided in April.

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

International developments have improved in line with the Riksbank's earlier forecasts, the recovery in the euro area appears, if anything, more robust and the risks of a setback are considered to have declined. It was noted that inflationary pressures primarily in the euro area are still low and that monetary policy abroad is expected to remain expansionary for a long time, something that Swedish monetary policy needs to take into account.

Swedish economic activity is strong and inflation has risen, becoming somewhat higher than expected in recent months. However, several board members emphasised that it was not sufficient for inflation to temporarily touch the 2 per cent mark. After a long period of below-target inflation, it is now particularly important that inflation is sustained close to 2 per cent. Ensuring this requires continued strong economic activity that gradually makes a greater impression on price growth. Several members here pointed to the importance of the krona not appreciating too rapidly in the current situation.

All members considered it a well-balanced policy to hold the repo rate unchanged at -0.50 per cent. A rate increase is not expected until mid-2018. As inflation has been somewhat higher than expected recently, and the risks abroad are considered to have declined, it is now somewhat less likely than before that the repo rate will be cut further in the near term. However, this does not rule out repo rate cuts in the period ahead. A couple of members also pointed out that it is important that the market does not pre-empt future rate increases, as this could make the Riksbank's work on attaining the inflation target more difficult.

Government bond purchases will continue during the second half of the year, as decided in April, and maturities and coupon payments will be reinvested in the government bond portfolio until further notice.

It was also discussed at the meeting why wage growth in the period ahead is expected to be relatively low and how this affects inflationary pressures. Furthermore, the risks associated with high and rising household indebtedness were also discussed.



MINUTES OF MONETARY POLICY MEETING

Executive Board, No. 3

DATE: 3 July 2017
TIME: 9.00 a.m.

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Samia Jubran, Board Member, Palestine Monetary Authority
Gary Watson

Jan Alsterlind
Carl-Johan Belfrage
Sophie Brauner
Meredith Beechey Österholm
Charlotta Edler
Paul Elger
Mattias Erlandsson
Kerstin Hallsten
Jens Iversen
Pernilla Meyersson
Ann-Lena Mikiver
Christoffer Nordenlöw (§ 1-3A)
Maria Sjödin
Ulf Söderström
Anders Vredin

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

§1. Economic developments

Christoffer Nordenlöw from the Markets Department began by presenting the latest developments on the financial markets. Since the April monetary policy meeting, a few central banks abroad have sent signals that monetary policy may become less expansionary going forward. Government bond yields abroad therefore rose in the week prior to the monetary policy meeting, but they are still low. The dollar has continued to weaken against both the euro and the krona, against the backdrop of weak American statistics, and the fact that the US administration is no longer expected to conduct such an expansionary fiscal policy. Since the monetary policy meeting in April, the krona has appreciated in trade-weighted terms, particularly in recent weeks. Prior to today's meeting, a majority of analysts expect an unchanged repo rate, that the Riksbank will reduce the likelihood of a rate cut in the near term, and an unchanged plan for bond purchases.

Mattias Erlandsson, acting Deputy Head of the Monetary Policy Department, presented new information obtained since the Monetary Policy Report was tabled. A weaker-than-expected outcome for retail trade in May has contributed to consumption being revised down somewhat, while a krona appreciation and a decline in the price of oil in recent weeks have led to minor downward revisions to the inflation forecast.

Anders Vredin, acting 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 the international forecast was largely unchanged compared with the previous forecast in April. GDP growth abroad (KIX-weighted) is expected to amount to just over 2 per cent in the years ahead, which is expected to lead to an increase in resource utilisation abroad. There is still uncertainty surrounding both economic and political developments, but the risks are deemed to be slightly smaller than in April. Inflation abroad is expected to slow slightly in the period ahead, partly as a consequence of the development in the oil price. Underlying inflation is still low but rising resource utilisation is expected to gradually push up inflation.

Mr Vredin noted that GDP growth in Sweden was lower than expected in the first quarter but that various indicators continue to show strong economic activity and continued good growth. The Riksbank's assessment is, therefore, that growth will rise over the next six months. During 2017 and 2018, growth is expected to overshoot its long-term trend, whereupon it will slow slightly and approach its long-term trend growth which amounts to about 2 per cent. From the production side, one reason for the slowdown in GDP growth in the period ahead is that slower population growth and increased matching problems are expected to lead to lower employment growth. From the expenditure side, GDP growth will slow partly as a result of migration expenditure being expected to have less of an impact on public consumption and of a lower rate of increase in housing construction.

Mr Vredin also noted that CPIF inflation has shown a rising trend since 2014 and amounted to 1.9 per cent in May. In recent years, rising energy prices have contributed to the upturn and CPIF inflation excluding energy is now further from 2 per cent than CPIF inflation. The contribution from energy prices is expected to be smaller this year, which means that CPIF inflation will be slightly lower. However, higher-than-normal resource utilisation is expected to contribute to inflation continuing to rise and it is calculated to stabilise around 2 per cent at the beginning of 2019.

Economic activity has developed in line with the assessment made in April. Inflation has been slightly higher than expected but an expansionary monetary policy is still required in order for inflation to stabilise close to 2 per cent. 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, that the first rate increase will occur around the middle of 2018 and that purchases of government bonds will continue during the second half of 2017 in accordance with the forecasts made in April. The fact that inflation has recently been slightly higher than expected and that the risks of setbacks abroad are deemed to have declined means that it is now considered less likely than before that the Riksbank will cut the repo rate in the near term.

Following this, Mr Vredin summarised the main features of the monetary policy drafting process. He noted that the forecasts and monetary policy assumptions were discussed with the Executive Board at meetings on 19 and 21 June. The draft Monetary Policy Report was discussed and tabled at a meeting with the Executive Board on 27 June. Mr Vredin identified a few important themes that were discussed during the process. One theme is how to look at the uncertainty surrounding economic policy development abroad. On the one hand, the outcome of the French election has reduced the risks to the European Union and the Economic and Monetary Union. On the other hand, there is still considerable uncertainty regarding, for example, economic policy in the United States and the United Kingdom. Overall, the assessment is that the risks are slightly smaller compared to April, which is also the picture given by pricing on the financial markets.

Another theme is how the Riksbank's monetary policy is affected by monetary policy abroad. Signals from the Federal Reserve and the ECB have led to changes in exchange rates and also in the krona. This is naturally something that the Riksbank constantly needs to monitor as the development in the krona is of importance for how and when inflation can stabilise around the target of 2 per cent.

A third theme, not just in Sweden but also abroad, is why wages are rising relatively modestly when the economic situation is deemed to be so good. This is discussed in an article in the draft Monetary Policy Report. The conclusion is that wage growth going forward is expected to be lower than could normally be expected bearing in mind the economic situation. Several different changes on the labour market are contributing to this. One explanation, which is relevant both in Sweden and abroad, is that productivity is developing relatively weakly. This is holding back real

wages. But it also contributes to holding up cost increases for companies and thereby helping inflation to rise.

§2. The economic situation and monetary policy

First Deputy Governor **Kerstin af Jochnick** began by saying that she agrees with the assessments and forecasts made in the draft Monetary Policy Report and that she supports the proposal to hold the repo rate unchanged at -0.50 per cent, adjust the near-term repo rate path and, as decided earlier, continue with purchases of government securities during 2017. She then discussed a few areas that have been important to her prior to today's monetary policy decision.

Economic activity continues to strengthen abroad and confidence indicators are high for both households and companies, Ms af Jochnick noted. Positive developments abroad are also creating increased demand for Swedish goods and services and are contributing to continued high growth and rising employment. Developments over the past months are quite well in line with the forecast adopted by the Executive Board in April.

Developments in the euro area are slightly better than expected, she continued. Growth this year is expected to be slightly higher than in previous forecasts. The earlier depreciation of the euro and lower oil prices have contributed to this. Confidence indicators are strong. Investment is expected to grow more rapidly in the period ahead due to stronger exports and higher capacity utilisation. With higher growth in the euro area, demand for Swedish goods and services should also increase. Political uncertainty in the euro area has subsided after the elections in the Netherlands and France. The monetary union now has a slightly more stable platform, which also seems to have improved trust in the future in the euro area.

Problems in the European banking sector are still being discussed and several EU organisations are working on harmonised measures to tackle non-performing loans. Decisions have been taken both in Italy and Spain to deal with problem banks. There is still a lot of work to be done, however, to safeguard a well-functioning banking sector in the euro area, Ms af Jochnick noted. At the same time, there are signs that companies in the EU are obtaining more of their funding on the market than previously, instead of going via the banking system, which can broaden companies' sources of funding in the long run and reduce dependency on bank funding. Overall, this gives a slightly more positive picture of developments primarily in the euro area.

Swedish economic activity is developing well and confidence indicators point to continued optimism among households and companies. GDP growth was weaker than expected in the first quarter, however. Tighter amortisation requirements from Finansinspektionen have also contributed to the forecast for GDP growth being revised downwards slightly. But resource utilisation is higher than normal and will continue to be high in the coming years.

CPIF inflation has shown a rising trend since 2014 and amounted to 1.9 per cent in May. The most recent inflation outcomes in Sweden have been slightly higher than forecast by the Riksbank. It is primarily service prices that have risen more than expected. This is partly a result of the seasonal effect linked to Easter becoming slightly more difficult to predict. Rising energy prices, in particular, have contributed to the upturn in inflation over the past 12 months. The oil price has fallen, however, since the Monetary Policy Report in April and the contribution from energy prices is expected to be smaller in the period ahead. Strong economic activity in Sweden and rising international price pressures are nevertheless helping to improve the conditions for CPIF inflation to stabilise around 2 per cent at the beginning of 2019.

Inflation may, however, be both higher and lower than the Riksbank's forecast, Ms af Jochnick continued. There is a risk of underestimating the strength of the European upturn and that demand for Swedish goods and services may be higher in the years ahead than the Riksbank expects. This could increase price pressures in the Swedish economy more than the Riksbank has calculated, she noted. There are also downside risks. A major and rapid appreciation of the exchange rate risks subduing import prices and demand, and make it more difficult to reach the inflation target as forecast. Oil prices also risk being lower than expected, which would also dampen inflation.

According to Ms af Jochnick, another core issue, discussed in an article in the draft Monetary Policy Report, is how stable historical correlations between wage development and economic developments are. Previously, the link between wages and economic activity in Sweden has been clear. During the forecast period, however, wage increases are expected to be moderate in relation to the domestic economic situation. An important explanation is that productivity has grown more slowly than previously in both Sweden and abroad after the global financial crisis. Another explanation is probably that weak wage development in the euro area has also subdued Swedish wages, as central wage agreements take Swedish competitiveness into consideration. There are also other factors that are increasing the uncertainty surrounding wage development, such as changes in the functioning of the labour market and that wage and inflation expectations may have been adjusted to the period of low inflation. But the shortage of skilled labour in both the private and public sector should lead to slightly higher wages in the long run. This is also the assessment made by companies in the Riksbank's business survey. It will contribute to inflation continuing to rise and stabilise around 2 per cent at the beginning of 2019.

Even though developments in the Swedish economy are currently very good, Ms af Jochnick pointed out that there are risks and vulnerabilities that may create problems for growth later on. One risk is from the labour market, where indicators of imbalances, such as labour shortages and recruitment times, show that it has become increasingly difficult for companies to recruit the staff they need. In the years ahead, population growth is expected to decline and mainly consist

of asylum and family member immigrants, who usually find it difficult to establish themselves on the labour market.

She went on to say that household indebtedness is a risk that the Riksbank has been alluding to for a long time and that is continuing to create unease. Even though Finansinspektionen is now tightening the amortisation requirements and the Government is paving the way for more macroprudential policy tools, the fundamental problems remain. Housing prices continue to rise and in May increased by an annual rate of almost 9 per cent. The incentives for households to borrow need to be further dampened to create better long-term conditions for the Swedish economy.

Ms af Jochnick then noted in conclusion that developments abroad, and particularly those in the euro area, are slightly more positive than at the monetary policy meeting in April, and that the political risks have decreased somewhat. But inflationary pressures also continue to be subdued abroad. In addition, inflation in Sweden has been slightly higher than the Riksbank's assessment in April. Ms af Jochnick therefore thought that it was justified, in the near term, to remove the higher probability of a rate cut than of a rate increase in the repo rate path. She added that this does not mean that the Riksbank cannot cut the repo rate further, but that, in her current assessment, the likelihood of further cuts has decreased.

Deputy Governor **Per Jansson** began by noting that the inflation picture has improved somewhat since the monetary policy meeting in April. Two new inflation outcomes have been published, for April and May. Both outcomes were slightly higher than expected. The most recent inflation outcome, which thus referred to May, reported CPIF inflation at 1.9 per cent, compared with a forecast of 1.7 per cent. For CPIF inflation excluding energy prices, the outcome was just under 1.6 per cent while the forecast was just over 1.3 per cent.

Comparing the forecast errors for April and May shows that the underestimation of inflation was approximately the same for both months, Mr Jansson continued. Of course, a forecast error is normally nothing to be happy about, but in this case, it actually is. And particularly pleasing is that the development of prices for services, which is key, has recovered quite significantly in the last two months. In March, prices for services increased by a moderate 1.2 per cent. The corresponding rates of increase in April and May were 2.3 and 2.4 per cent respectively. Even if the uptick depends to a certain extent on more temporary price movements, this development confirms the picture of more underlying inflation, according to a number of different indicators, now showing signs of establishing itself close to 2 per cent more sustainably.

Mr Jansson pointed out that the development of inflation expectations is also contributing to the improved inflation conditions. Here, also, two new outcomes have been published since the last monetary policy meeting, for May and June. The overall picture is that expectations are

continuing to rise. As regards inflation expectations two and five years ahead, the deviations from the inflation target are now very small. Expectations one year ahead have also risen significantly and are at or above 1.7 per cent for all groups in the June questionnaire. This underlines the fact that the inflation target is now fully credible and that conditions are therefore in place for the Riksbank to be able to stabilise the inflation rate close to 2 per cent going forward, he said.

Mr Jansson noted that, against the backdrop of the unexpectedly high inflation outcomes, it is now proposed in the draft Monetary Policy Report to revise the forecast for CPIF inflation excluding energy prices upwards slightly over the next few months. As regards CPIF inflation, the impact on the forecast in the near term is assumed to be less as the starting point is now also that the oil price will be lower than previously predicted. The lower oil price, together with a slightly stronger krona, in fact means that the forecast for CPIF inflation has been slightly revised downwards for late autumn this year and spring 2018. In the latter stages of the forecast period, however, the changes in the assessment for both CPIF inflation and CPIF inflation excluding energy prices are marginal. These more long-term inflation forecasts are determined to a higher degree by the fundamental economic outlook, which, in the draft report, is deemed to be about the same as in April, despite an unexpectedly weak GDP outcome for the first quarter. The relatively low growth at the start of the year is seen as temporary and the economic outlook for the period ahead is relatively bright in light of, for instance, an improved economic situation abroad, good growth in real disposable household income, strong household wealth and rapid growth in employment. Much of this is a result of the Riksbank's expansionary monetary policy, he stated.

Mr Jansson's summary was that the draft Monetary Policy Report thus paints quite a bright picture of the Swedish economy. The fact that the risks of setbacks abroad are now deemed to have diminished, especially as a result of the positive outcome in the French presidential election, of course does not worsen the conditions for a good development. While the draft report forcefully rejects the idea of starting to make monetary policy less expansionary at this stage, it nevertheless proposes that the forecast for the repo rate should now reflect that it is somewhat less likely than before that the Riksbank will undertake a rate cut in the near term. He observed that similar changes to the risk outlook for the policy rate have been made by a number of central banks abroad of late, including the ECB.

Mr Jansson said that he could go along with the proposed change to monetary policy, as well as the other assumptions for monetary policy and the forecast made in the draft Monetary Policy Report. But he wished to emphasise that the change does not in any way affect his preparedness to support a more expansionary monetary policy should the need arise. If the repo rate needs to

be cut again, he would thus not hesitate for a moment as regards spearheading and standing behind such a decision. And Mr Jansson understood the messages on monetary policy preparedness agreed on by the Executive Board and presented in the draft Monetary Policy Report as this being a viewpoint basically shared by all Executive Board members, even if there may naturally be different opinions about the meaning of the word “need”.

What then is required for it to be possible to start seriously discussing an exit from the very expansionary policy, Mr Jansson asked himself. To process his own thoughts, he had tried to formulate three, not mutually independent, conditions. The first, and clearly the most important condition, is that the more underlying inflation rate is close to 2 per cent for several months. It is worth noting here that an important “test” will take place in the period ahead when higher demand-driven inflation is to compensate for negative contributions from both energy prices and the krona exchange rate. He pointed out that the recent development in the krona exchange rate, with a rapid appreciation against the US dollar as well as a strengthening against the euro, is obviously not something that increases the likelihood of this test being passed.

The second condition is precisely that the Swedish krona must not appreciate too quickly and too much. Here, in Mr Jansson’s view, many critics of the Riksbank’s monetary policy are overlooking the fact that such a development would not only have major negative effects on inflation but would also of course cause a significant slowdown in the growth of the Swedish economy. These critics seem often to reason as if the exchange rate has no bearing on the real economy and the Riksbank’s ‘fixation’ with the krona only has to do with inflation. This reasoning is not only incorrect but also dangerous, he said.

The third condition is for other central banks, especially the ECB but also the US Federal Reserve, to be more concrete about, or to a larger degree start, unwinding their expansionary policies. In light of Sweden being a small open economy with significant trade with other countries, in particular the rest of Europe, a premature unwinding of the expansionary Swedish monetary policy, relative to the monetary policies conducted abroad, would be associated with major risks. Mr Jansson stressed that the Riksbank’s monetary policy need not slavishly follow every movement made by these large central banks, but after a very long period of excessively low inflation and extremely expansionary global monetary policy, the scope for deviation is clearly less than normal. A readjustment of monetary policy abroad would not only be good from the point of view of the Riksbank’s assignment, but also in light of it confirming that the international recovery is on a firmer footing and that the outlook for inflation is improving, he reasoned.

Mr Jansson wished to conclude by pointing out that all this is a discussion about principles that does not mean that he expects Swedish monetary policy to change tack soon, were anyone to think this was the case. He underlined that, according to his own assessment, the first two

conditions will be very difficult to meet unless the third condition is also fulfilled, or even worse, so to speak, if it were to go in the opposite direction. If the ECB continues to buy more assets next year, a scenario expected on the financial markets, it will probably be very difficult for the Riksbank to stop new purchases altogether already at the turn of the year, according to Mr Jansson. Important work during the autumn is therefore to continue and deepen the analysis of which financial assets might be the subject of further purchases, he thought.

Deputy Governor **Martin Flodén** began by supporting the proposal to hold the repo rate unchanged at -0.50 per cent, the proposed repo rate path and the rest of the forecast in the draft Monetary Policy Report.

Mr Flodén noted that economic developments in Sweden and abroad have largely been in line with the forecasts presented by the Riksbank in connection with the monetary policy meeting in April. New information received since then has been largely positive. Especially pleasing is that the inflation outcomes in Sweden have been slightly higher than expected by the Riksbank. In addition, the conditions for continued economic recovery in the euro area now seem to be more robust. This is a result both of the recovery having continued without any clear setbacks and forward-looking economic indicators having continued to strengthen, and of the political uncertainty surrounding the future of the European Union having decreased.

He noted that the higher inflation outcomes for April and May mean that the upturn in inflation is now on a slightly firmer footing than in April. The continued economic upswing and the reduced risks abroad also mean that setbacks for the upturn in inflation are now less likely. This in turn means that the risk of there being a need for an even more expansionary monetary policy during the autumn has subsided. Mr Flodén therefore considers it appropriate for the Riksbank to revise the near-term forecast for the repo rate upwards in the way proposed in the draft Monetary Policy Report. He pointed out that at the April meeting, he had wished to defer the decision on extended purchases of government bonds and that he would not have supported such a decision at today's meeting either.

Due to the higher inflation outcomes and generally more stable developments abroad, it is relevant, according to Mr Flodén, to ask whether the Riksbank's forecast for the repo rate also in the slightly longer term should be changed. His assessment is that it should not be changed but that the rate path from April still shows the most likely development for the repo rate next year. Most of the indications are still that the surprisingly high outcomes for inflation in April and May were caused by temporary effects, for example, new seasonal patterns for charter travel prices. The high inflation outcomes may contribute to higher inflation expectations and a more robust confidence in inflation being on the right track, and hence to a lessening of the monetary policy

risks in the near term. But underlying inflationary pressures in the medium term have probably still not risen.

He pointed out that there are other factors suggesting that the suitable timing of the first rate increase remains the same, or has perhaps even moved towards a postponement. One such factor is that wage increases continue to be subdued and that the Riksbank's forecast for these has again been revised down slightly. Another is that the oil price has fallen in recent months. This will hold down CPI inflation and may, via inflation expectations and other indirect mechanisms, also hold down underlying inflation slightly. Another factor is that market participants have now more clearly started to discuss and expect rate rises that occur earlier than in the Riksbank's forecast. This has led to rising market rates and a strengthening in the krona compared with the Riksbank's April forecast, something that will lead to downward pressure on inflation in the year ahead. The more the market prices in an earlier repo rate increase than in our forecast, the more likely it will become that the repo rate will instead be raised even later.

Mr Flodén also wished to discuss how monetary policy relates to the strong economic situation. According to the Riksbank RU indicator, resource utilisation is significantly higher than normal. Other measures and assessments of the economic situation provide a similar picture. Forward-looking indicators also suggest that economic activity will remain strong in the years ahead. It is, of course, unusual that monetary policy is expansionary in such a strong economic situation. A relevant question is whether the elevated level of economic activity is problematic and hence calls for a tighter monetary policy.

A common reason for wanting to counteract high resource utilisation is that price and wage increases might otherwise soar to excessively high levels. Another cause for concern regarding high resource utilisation is that it may lead to resources being allocated to the wrong sectors and activities, or that the development is based on unjustified optimism leading to unsustainably high consumption.

According to Mr Flodén, the risk of price and wage increases being too high must in the current situation be deemed low. And even if inflation were to become unexpectedly high, it would hardly be a major problem since inflation has been too low for many years. Neither are there clear signs that the real economy is, or is starting to become, overheated in a problematic way. Household consumption continues to grow, but at a rate that is quite modest in relation to the strong economic activity. The household saving rate is therefore high. Public finances are also strong and the current account continues to show clear surpluses.

Something that may be a slight cause for concern is the rapid upturn in housing investment in recent years. The major fluctuations in the level of activity in the construction sector may pose

risks. But the high level of housing investment must also be seen in light of several decades of very low construction. For example, he pointed out that, according to Boverket's (National Board of Housing, Building and Planning) assessment, construction needs to be on an even higher level several years ahead in order for us to have a better balance between supply and demand.

The strong economic situation therefore does not clearly indicate that there is a need for a tighter monetary policy. On the contrary, there may be reason to welcome the strong economic activity. In a benign scenario, a more normal resource utilisation is achieved by strengthening production capacity, rather than dampening economic activity. For example, unemployment is still high in certain population groups and the high resource utilisation may make it easier for those who have a weak connection to the labour market to gain a foothold on it.

Mr Flodén concluded by summarising his opinion that the conditions for a continued upturn in inflation have developed more or less in line with the Riksbank's forecast in April, that the risks in the near term have subsided slightly but that the upturn in underlying inflation is still dependent on support from a very expansionary monetary policy.

Deputy Governor **Cecilia Skingsley** began by noting that today's meeting marks three years since the Riksbank performed an extraordinary rate cut of 50 basis points. It was a decision taken to underline the importance of returning inflation to the target. CPIF inflation had fallen below 1 per cent a few months before and inflation expectations had been declining for two years. At the July meeting in 2014, it was forecast that the repo rate would remain at 0.25 per cent until the end of 2015 before increases could be back on the agenda.

Now, three years on, it is clear that further easing has become necessary and that the period until rate increases could begin again has turned out to be significantly longer. In addition, the challenge of excessively low inflation has been shared by many countries. Since July 2014, monetary policy easing has taken place in Australia, Canada, the euro area, Japan, Norway and Switzerland, to name but a few examples.

Ms Skingsley also noted that the reasons why the period of low inflation and monetary policy easing turned out to be so much longer than expected have been analysed in many different versions. In the most concise version, the explanations are: a long-term adjustment after the financial crisis; lower global real interest rates; a fall in energy prices; declining inflation expectations; political uncertainty factors; and structural changes in the economy.

As resource utilisation has risen, and inflation and inflation expectations have approached the inflation target, the spectrum of opinions on what is a suitable monetary policy has broadened in the Executive Board, Ms Skingsley noted. She entered a reservation against the expansion of the bond-purchasing programme adopted in April and starting in the second half of the year referring to the fact that the economy is already strong and that there was scope to backtrack if the

development of inflation was under threat. She still thinks that this is a reasonable assessment, but since the interruption of an already-adopted programme would cause turbulence for rate-setting and the exchange rate, she was refraining from putting forward such a proposal at today's meeting.

Even though inflation this past spring has reached 2 per cent, it is too early for the Riksbank to congratulate itself. This is due partly to the forecast suggesting lower inflation in the months ahead and partly to the period of low inflation having been so long. It is important to tread cautiously when it comes to future rate increases, according to Ms Skingsley, as she supported the repo rate path proposal, according to which the first increase will not take place until mid-2018.

According to the current rate path, the period with a negative repo rate will then amount to more than 4 years, Ms Skingsley pointed out. This policy has come under criticism, and there are proposals to quickly raise the repo rate back into positive territory again, she noted. Although she understands why people may disapprove of low interest rates, it worries Ms Skingsley that the critics seldom say what they base their analysis on when they argue for an immediate return to a positive repo rate. Is there something wrong with the Riksbank's statutory price stability task? Or is the Riksbank misinterpreting the task, or do they have a different macro-economic forecast that justifies a tighter monetary policy? Using the repo rate to subdue the housing market, for instance, would require rates of several per cent, which would mean a failure for both growth and inflation. On her part, Ms Skingsley does not consider such a policy to be feasible based on how the Riksbank's mandate has been defined by the Riksdag.

Just as at previous meetings, Ms Skingsley is still concerned about the sustainability of household debt growth. She welcomes Finansinspektionen's proposal for tighter amortisation requirements for new borrowers with high debt-to-income ratios. She also wished to clarify her position that macroprudential policy would inspire greater confidence among economic agents if Finansinspektionen had been empowered to, within the framework of a set of predefined tools, take this type of decision itself rather than having first to seek the approval of the Government.

Regarding her future choices for monetary policy, it is still important for Ms Skingsley that inflation expectations are anchored around the inflation target of 2 per cent and that actual inflation stabilises around this target. She currently does not see any convincing signs, either internationally or in the Swedish economy, that would justify an earlier start to rate increases or a faster pace once they have been initiated. The repo rate level that neither accelerates nor applies the brake on the economy is difficult to determine but it is probably low in the current

situation and may even be low in the long term.¹ In order not to be surprised by an anti-inflationary slowdown of the economy, it is therefore important that normalisation takes place gradually.

In addition, Ms Skingsley noted that activity-wise, the world and Sweden are developing positively, and approximately in line with the previous forecast. A lot of analytical work remains, however, in order to understand structural forces and changes in both the international and domestic economy. The article about subdued wage increases despite a high level of resource utilisation provides important pieces of the puzzle when it comes to explaining the low price growth. Furthermore, deeper analysis is needed of what factors such as technological development mean for the interaction between resource utilisation and wages, and whether changed balances of power between employers and employees affect wage formation. It is here a question of being curious while still exercising analytical caution, according to Ms Skingsley. What appear to be major structural changes in individual industries or geographical regions may actually be reasonable relative changes when resources are moved from less to more productive sectors in the economy. This does not need to be something to which monetary policy should react.

In conclusion, Ms Skingsley reiterated her support for the forecasts, analysis and monetary policy proposals in the report.

Governor **Stefan Ingves** began by expressing his support for the monetary policy proposed in the draft Monetary Policy Report. The recovery is continuing approximately as expected. The forecast revisions are minor and CPIF inflation is now close to target. The global financial crisis led to widespread negative economic shocks and recovery has taken a long time. Interest rates in several countries are still very low compared to normal. According to Mr Ingves, the Riksbank's monetary policy and asset purchases have worked approximately as expected and contributed to higher resource utilisation and rising inflation and inflation expectations.

The recovery is continuing abroad; industrial activity is strengthening and global trade is increasing. Optimism about the future is rising among households and companies, according to various confidence measurements. In the United States, however, growth slowed slightly in the first quarter of this year, but confidence indicators point to higher growth in the period ahead. At the same time, there is considerable uncertainty about the economy in a broad sense. The Federal Reserve raised the interval for its policy rate in June and indicated that reinvestments of maturities in the securities portfolio will be gradually phased out and communicated in good time before they begin.

¹ The Riksbank previously adjusted the level of the long-term repo rate downwards. In the Monetary Policy Report published in February 2017, the long-term repo rate was calculated to be in the interval of 2.5 – 4 per cent. The previous estimate was 3.5 – 4.5 per cent.

In the euro area, growth increased during the first quarter of this year compared with the previous quarter. Resource utilisation is expected to rise gradually during the forecast period. The political risks have subsided slightly and the yield gaps between Germany and several other European countries have decreased. But there are still risks in the financial system, Mr Ingves pointed out. Several banks have poor profitability and a large proportion of non-performing loans, which poses risks to the recovery in the real economy in the euro area. This is not least true of Italy, which has seen weak economic development for a long time with weak banks and high national debt, and where central government is injecting capital in conjunction with the winding-up of banks.

The ECB held its negative deposit rate unchanged in June and is continuing with the announced asset purchases until the end of 2017, or longer than that if necessary. Monetary policies in the major currency areas, the US and the euro area, are hence in different phases, even if they are still expansionary.

GDP growth in the countries that are most important for the Swedish economy (KIX-weighted) is expected to rise from about 2 per cent in 2016 to 2.5 per year in 2017. In 2018 and 2019, growth is expected to be 2.3 per cent on average. This is also reflected in the Riksbank's assessment of Swedish growth.

In Sweden, economic activity remains strong, Mr Ingves continued. However, GDP growth was somewhat weaker than expected during the first quarter of this year. But households and companies continue to be optimistic. Growth in employment and labour force is still high. Many companies are reporting a shortage of labour. Resource utilisation is higher than normal and will continue to be high in the coming years. Rising resource utilisation and forward-looking indicators suggest underlying inflationary pressures will increase in the period ahead. Strong domestic economic activity and rising international price pressures suggest that companies may find it easier to increase prices. CPI inflation is expected to stabilise around 2 per cent in 2019, in line with the previous forecast. Inflation expectations have risen significantly since 2015. In June, average inflation expectations five years ahead were 2.1 per cent in the sample of all participants, according to Prospera. This helps the inflation target to act as a credible anchor for price-setting and wage formation, Mr Ingves noted.

Regarding monetary policy, Mr Ingves 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 start to be increased slowly in mid-2018. Purchases of government bonds will continue during the second half of 2017, as decided in April. Just as in many other countries, Swedish monetary policy is thus very expansionary and will remain so in the coming years. It is important that future rate increases are not pre-empted, Mr Ingves stressed. This is also true of speculations about the Riksbank's bond purchases. For the Riksbank, it is important to keep to the monetary policy plan and be prepared

to work with the entire balance sheet until inflation stabilises around 2 per cent, according to Mr Ingves. Inflation just touching two per cent in the short term is not stable enough.

This means that the Swedish exchange rate is one thing we need to keep an eye on, Mr Ingves continued. A rapid krona appreciation, as a result of, for example, changes to monetary policy in the major currency areas, poses a risk that requires vigilance from the Riksbank. In addition, wage development in the period ahead is uncertain. After the global financial crisis, wages have increased less than is indicated by historical correlations between economic activity and wages, both abroad and in Sweden. One probable explanation is lower productivity growth. Another can be greater global competition. Added to this is, for example, the fact that wages in Sweden are affected by central wage agreements, which consider wage development abroad and Swedish competitiveness.

In the forecast, the assumption is that wage increases will continue to be lower than historical correlations indicate. Although it is true that wages over and above central agreements are expected to increase more rapidly than in recent years, the new wage agreements suggest moderate wage growth, despite strong domestic economic activity. The possibility of wage increases being lower or higher than this forecast cannot be ruled out, but the overall assessment is that resource utilisation will be high enough to push up and sustain inflation at around 2 per cent in early 2019.

Bearing in mind the fact that the economy has been strengthening for a long time, neither is it possible to rule out the risk of setbacks, in Mr Ingves's view. The political risks have indeed decreased slightly, but there are financial imbalances in several parts of the world, both in Europe and a number of emerging market economies, that can contribute to shocks that spill over into our open economy and our large financial system.

Often, an economic slowdown starts with inflation taking off and central banks needing to cool down the economy via rate hikes. On several occasions in recent decades, the economic downturn has instead been triggered by a financial crisis after a long period of rising asset prices and high indebtedness in the private sector. The Bank for International Settlements (BIS) points to a number of risks in its new annual report. It notes, for example, that indicators of financial stress are showing risks in several countries.

This may relate to emerging market economies or developed countries that were not as hard-hit as the most exposed countries during the global financial crisis but have since incurred growing financial imbalances. In emerging market economies with relatively high indebtedness in US dollars, there is a danger of strong fluctuations in interest rates and exchange rates along with less risk appetite, in conjunction with less expansionary US monetary policy and a stronger dollar.

In this context, the Swedish housing market constitutes its own special chapter, Mr Ingves continued. It continues to be highly valued in an historical perspective. In May, housing prices

rose by an annual rate of 8.6 per cent. Household debt continues to increase more rapidly than household income. High housing prices and increasing household indebtedness still pose very large risks to economic and financial stability in Sweden. Finansinspektionen's proposed tightening of the amortisation regulations is welcome, as is the Government's proposal for additional macroprudential policy tools. More measures are needed within several policy areas, however, to limit the build-up of debt in the household sector and to improve the Swedish housing market. It is the height of summer in the Swedish economy but large household indebtedness and the Swedish housing market are forming threatening thunder clouds on the horizon.

Deputy Governor **Henry Ohlsson** began by supporting the proposals to hold the repo rate unchanged at -0.50 per cent and to adjust the repo-rate path upwards slightly.

The outcomes for key Swedish macroeconomic variables show a very positive development for the Swedish economy in recent years. The expansionary monetary policy conducted by the Riksbank is a strong contributory factor to this, in Mr Ohlsson's view.

The most recent inflation figures in May showed an annual rate of increase for the CPI of 1.9 per cent. The corresponding figure for April 2017 was 2.0 per cent. Inflation is thus close to the inflation target. The June reading of five-year inflation expectations among money market participants was 2.0 per cent. Expectations for two years ahead were 1.9 per cent in the same reading. In all these cases, however, it is a question of measurements for individual months. Inflation, both in terms of outcomes and expectations, has to be stable around the inflation target before it can be said that the target has been reached.

The real macroeconomic variables are also developing well, Mr Ohlsson continued. GDP growth is rapid. According to the Monetary Policy Report, calendar-adjusted GDP is calculated to grow by 2.5 per cent in 2017 and 2018. This is a high figure in a historical comparison. The outcome for the first quarter of 2017 was not as strong as many had expected, however. Here, it is important to remember that the National Accounts are constantly being revised, Mr Ohlsson pointed out. Preliminary outcomes are changed. We still don't know the final outcome for the first quarter of 2017.

Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. In May, the percentage of openly unemployed fund members was 2.2 per cent. This is 0.4 percentage points lower than the same month one year earlier. The latest labour force surveys (LFS) also indicate that unemployment is continuing to fall. In May 2017, unemployment stood at 7.2 per cent (not seasonally adjusted). This is nearly half a percentage point lower than the same month last year. The conclusion to be drawn from the two unemployment figures is that the improvements are not just benefiting the strongest. The

development is pleasing, finding a job does not just have short-term effects but can affect a person's entire working life. According to Mr Ohlsson, however, unemployment is still on too high a level.

The National Institute of Economic Research's Economic Tendency Survey points to an increasing shortage of labour. The number of vacant positions is increasing according to statistics from both Arbetsförmedlingen (the Swedish Public Employment Service) and Statistics Sweden. Here, it is important to point out that a vacant position does not necessarily mean that the working task is not being performed. Most vacant positions are not necessarily job vacancies. In most cases, the working tasks are performed by substitutes, staffing agencies and the like. This indicates that there is flexibility in the labour supply. Free movement within the EU also leads to greater labour supply on the Swedish labour market. It is therefore not so remarkable that the rising demand for labour has not led to wage growth.

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

The conclusion from developments in the real 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. According to Mr Ohlsson, this in itself is not necessarily a restriction for current monetary policy. In the prevailing economic situation, when inflation is below target, there is, in his view, no conflict of interest between real economic activity and inflation. What can happen in this situation? Higher inflation? Yes, but that is exactly what the Riksbank is striving for until the inflation target has been reached.

In conclusion, Mr Ohlsson noted that inflation is still below target. This calls for continued expansionary monetary policy. At the same time, Mr Ohlsson's view is that there are obvious risks associated with making monetary policy even more expansionary. It is a question of weighing the advantages of different monetary policy options against the disadvantages. Mr Ohlsson's monetary policy conclusions are that the repo rate should be held unchanged and that the repo rate path be adjusted upwards slightly. He also supported the Monetary Policy Report.

§3. Discussion

Deputy Governor Henry Ohlsson began the discussion by noting that, at the April meeting, he had entered a reservation against extended purchases of government bonds. He wished to point out

that he shared Mr Flodén's view and that he therefore would have entered a reservation if the April proposal had instead been tabled at today's meeting.

Governor Stefan Ingves referred to Mr Flodén's observation that rising market rates as a result of expectations of earlier future rate increases can put downward pressure on inflation, which might therefore lead to the repo rate being raised even later. According to Mr Ingves, it is therefore important to be clear that the repo rate path is the Riksbank's best assessment of the interest rate development required to reach the inflation target.

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

The Executive Board decided

- to adopt the Monetary Policy Report according to the proposal, Annex A to the minutes, and
- to hold the repo rate at -0.50 per cent,

§5. Other decisions

The Executive Board decided

- to publish the Monetary Policy Report and decisions under Section 4 with the motivation and wording contained in a press release at 9.30 a.m. on Tuesday 4 July 2017, and
- to publish the minutes of today's meeting on 18 July 2017, at 9.30 a.m.

This paragraph was verified immediately.

Minutes taken by

Sophie Brauner

Verified by:

Stefan Ingves

Martin Flodén

Per Jansson

Kerstin af Jochnick

Henry Ohlsson

Cecilia Skingsley



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