Monetary policy minutes

February 2017

SVERIGES RIKSBANK

Summary

At the monetary policy meeting on 14 February, the Executive Board of the Riksbank decided to hold the repo rate at −0.50 per cent and there is still a greater probability that the rate will be cut than that it will be raised in the near term. The purchases of government bonds will continue for the first six months of 2017, as was decided in December. The Executive Board has also taken a decision to extend the mandate that facilitates a quick intervention on the foreign exchange market.

It was noted at the meeting that the Executive Board agreed on the outlook for economic development and inflation described in the draft Monetary Policy Report.

Since the last monetary policy meeting in December, outcomes and indicators have confirmed the Riksbank's view of an economic recovery abroad and strong economic activity in Sweden, and the revisions in the forecasts are largely minor. At the same time, political uncertainty is considerable in many parts of the world and the risks of setbacks have increased.

It is pleasing that economic activity is strong in Sweden and that inflation expectations are now back in line with the inflation target. CPIF inflation in December was also close to 2 per cent, but it is important to point out that the recent upturn has been mostly driven by temporary factors. It is the assessment of the Executive Board members that it will not be until the end of 2018 before inflation stabilises around 2 per cent.

Inflation has been low for a long time and continued strong economic activity and a krona that does not appreciate too rapidly are required for inflation to sustain itself on a level close to the inflation target. Political uncertainty abroad, which can ultimately have a negative impact on the development of Swedish economic activity and inflation, also underlines the need for monetary policy to remain expansionary.

All members deemed it appropriate to hold the repo rate at −0.50 per cent. Opinions differ slightly in the Executive Board as to the exact formulation of the repo rate path but all the members support the repo rate forecast. This forecast reflects the fact that there is still a greater probability that the rate will be cut than that it will be raised in the near future, and that slow increases will not begin until the start of 2018.

Moreover, a majority of members considered it appropriate to extend the mandate facilitating rapid intervention on the foreign exchange market, against the backdrop of the major uncertainty that prevails regarding the development of the krona exchange rate and the consequences it may have for inflation. One member did not support this proposal.

Purchases of government bonds will continue according to the plan adopted in December.

Aspects of the risks associated with the growing household indebtedness were also discussed at the meeting. The Executive Board is in agreement that these risks need to be managed using targeted measures in housing policy, tax policy and macroprudential policy.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 1

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DATE: 14 February 2017

TIME: 09.00

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

Susanne Eberstein, Chairperson of the General Council
Michael Lundholm, Vice Chairperson of the General Council

Jan Alsterlind
Carl-Johan Belfrage
Claes Berg
Sophie Brauner
Charlotta Edler
Paul Elger
Heidi Elmér
Mattias Erlandsson
Kerstin Hallsten
Jens Iversen
Jesper Johansson
Pernilla Meyersson
Ann-Lena Mikiver
Marianne Nessén
Christina Nyman
Lena Strömberg (§ 1-3A)
Maria Sjödin
Ulf Söderström
Jens Vahlquist (§ 1-3A)

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

§1. Economic developments

Jens Vahlquist from the Markets Department began by presenting the latest developments on the financial markets. Fluctuations on the fixed-income and foreign-exchange markets have been small in recent months. The appreciation of the US dollar has halted recently, after the dollar had strengthened in the wake of the presidential election and the Federal Reserve's interest rate rise in December. Changes in long-term US and German government bond yields have been very small. No concrete decisions have been made on the future US fiscal policy and both the Federal Reserve and the ECB decided to leave their policy rates unchanged at their most recent monetary policy meetings. In contrast, interest rates in some euro area countries have been pushed up due to a certain amount of unease over populist successes in Europe, as well as speculation that strong inflation data could get the ECB to decrease asset purchases. The clear depreciation of the Turkish lira has caused some unease considering that French and Spanish banks have lent large amounts to the Turkish business sector, but this development has stabilised recently. The Swedish krona has appreciated since the meeting in December, but has been relatively stable since the start of the year. Long-term Swedish inflation expectations have risen, according to both surveys and the market pricing of nominal and real bonds. Ahead of the day's monetary policy decision, a majority of analysts expect the repo rate to be held unchanged, the repo rate path to be revised upwards slightly in the near term and there to be no new developments regarding bond purchases.

Ulf Söderström, acting Head of the Monetary Policy Department, began by presenting the forecast included in 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 observed that the international recovery was proceeding at a modest pace and that indicators of economic activity have strengthened slightly recently.

This slight strengthening of international economic activity is in line with the forecast from December and has therefore not led to any greater revisions of the international forecast. International growth is marginally higher in the near term and KIX-weighted growth is expected to rise from 2.0 per cent in 2016 to just over 2.2 per cent per year for the years 2017 to 2019. However, the political situation in several parts of the world, particularly the United States, makes developments difficult to predict.

International inflation has risen recently. This increase is so far largely due to the development of energy prices. A gradually higher degree of resource utilisation will contribute towards the continued rise of inflation in the period ahead, albeit at a slow pace. All in all, KIX-weighted inflation will be slightly over 2 per cent for the entire forecast period. Monetary policy abroad is expected to continue to be very expansionary to support the recovery and boost inflation.

As regards the risk outlook, great uncertainty prevails over political developments in many countries and the risk of setbacks has increased. In the United States, it is very uncertain how immigration laws will be designed, which fiscal policy will be conducted and to which extent trade policy will become more protectionist. The forms of a British withdrawal from the EU remain unclear, even if the withdrawal is expected to be linked to reduced trade and more restricted movement of the labour force. In Europe, elections are to be held over the year that could strengthen the trend towards more inward-looking economic policies. All in all, increased protectionism is thus deemed to constitute a risk for long-term global growth. However, the effect of increased protectionism on international inflation is unclear. The European banking sector, not least in Italy, is still struggling with weak profitability and a large proportion of non-performing loans. This too poses a risk to the recovery of the euro area.

Economic activity in Sweden is increasingly strong. Confidence measures show that optimism among both companies and households has increased and that export orders have strengthened at the same time. Growth in the Swedish economy is therefore expected to remain strong. In 2016, growth is expected to have been 3.4 per cent. This year, growth is expected to amount to 2.5 per cent and then to slow down slightly to just over 2 per cent in 2018 and 2019. The high growth in recent years has led to an increase in resource utilisation, which is now deemed to be higher than normal, and which will continue to rise somewhat in the coming years.

Demand for labour is expected to remain high. However, the employment rate is already so high, especially in certain groups, that it is increasingly difficult for companies to find the staff they are seeking. Growth in employment is therefore expected to slow down in the coming years and the employment rate will level off at a high level. As the labour force increased in 2016, unemployment only decreased slowly and amounted to 6.9 per cent over the fourth quarter of 2016. The downturn in unemployment is expected to slow down this year and unemployment to rise somewhat in 2019.

Household debt as a proportion of disposable income continues to rise and is expected to amount to close to 195 per cent at the start of 2020, compared with the current level of just over 180 per cent.

Over most of 2016, the krona depreciated relatively substantially. Since the monetary policy meeting in December, the krona has instead appreciated and is now expected to be slightly stronger over the entire forecast period compared with December's assessment. As in December, the krona is expected to strengthen gradually and in an orderly manner.

CPIF inflation has shown a rising trend since the beginning of 2014 and increased to 1.9 per cent in December. CPI inflation was 1.7 per cent. This was somewhat higher than in the December forecast. But it is mainly energy and food prices that have pushed inflation up and, when energy prices can no longer be expected to contribute as much, CPIF inflation is expected to fall back slightly in 2017. Underlying inflation, measured as the CPIF excluding energy (CPIFxe), continues to be low. It amounted to 1.3 per cent in December and developed weakly in 2016. The conditions are deemed to be in place for a continued increase in inflation in the period ahead. One important factor is the rising level of resource utilisation, which contributes to higher inflation subject to a certain time lag. The forecast for CPIF and CPIFxe inflation has been revised slightly downwards for 2018 and 2019, compared with the previous forecast, as the krona is now expected to be stronger. Both measures are expected to rise gradually and reach 2 per cent towards the end of 2018.

The forecasts are based on the assumption that the repo rate will be held unchanged at −0.50 per cent. The repo rate path reflects the fact that there is still a greater probability that the rate will be cut than that it will be raised in the near future, and that slow increases will not begin until early 2018. The purchases of government bonds will continue for the first six months of 2017, according to December's decision. In addition, maturities and coupon payments on the government bond portfolio are expected be reinvested until further notice. During 2017, these maturities and coupon payments will amount to around SEK 30 billion and they are planned to continue throughout the year. In addition, the mandate facilitating rapid intervention on the foreign exchange market has been extended until October 2017, justified by the great uncertainty prevailing over the development of the krona and its consequences for inflation.

Mr Söderström then noted that the forecasts and monetary policy assumptions were discussed with the Executive Board at meetings held on 26 and 30 January and on 6 February. The draft Monetary Policy Report was discussed and tabled at a meeting with the Executive Board on 8 February.

Important issues highlighted in the monetary policy drafting process this time included international uncertainty, the development of the krona and the trend in inflation.

One important issue has been the risk of more inward-looking policies considering the unpredictable developments in the United States and United Kingdom and the several elections to be held in Europe in 2017. Several members raised the issue of how more inward-looking policies could affect the conditions for growth and inflation in Sweden. A discussion has also been held over why yield spreads between different euro area countries' government bonds have increased and the consequences this could have. The political uncertainty stands in contrast to different measures of confidence and risk, which give a relatively positive view of developments in Sweden and abroad.

The krona depreciated relatively heavily over most of 2016, but, since December, it has appreciated again. As a result of these krona fluctuations, many members have discussed what is causing them and how they may affect inflation in the short and slightly longer terms.

Inflation has risen in recent months, slightly faster than was expected in December, and CPIF inflation is now close to 2 per cent. As this is very much due to movements in energy prices, several members have noted that underlying inflation continues to be low, both in Sweden and abroad. CPIF inflation is thus expected to fall back slightly in the period ahead. The Executive Board has also continued to discuss the connection between resource utilisation, wages and inflation. In addition, some members of the Executive Board have discussed whether changes have occurred in the wage formation process that could have affected the relationship between the level of economic activity and wage development.

§2. The economic situation and monetary policy

Deputy Governor **Martin Flodén** opened by observing that economic developments in Sweden and abroad have been roughly in line with the view held by the Riksbank at the latest monetary policy meeting in December. However, several outcomes and indicators on the margin suggest that the development of both inflation and growth in the near term are slightly stronger than expected. For example, the outcomes for Swedish inflation in December were marginally higher than in the Riksbank’s latest forecast. Mr Flodén noted that many commentators attach great weight to the fact that CPIF inflation was only a few hundredths of a percentage point from 2 per cent. As inflation becomes higher and inflation expectations for various durations approach 2 per cent, more and more people are starting to wonder when the monetary policy expansion will start to slow down.

For Mr Flodén, it is not particularly interesting whether CPIF inflation is 1.9 or 2.0 per cent, particularly not when inflation is presently being pushed up by temporary factors. The development of underlying inflation, for example measured as the CPIF excluding energy, is more important. According to this measure, inflation in December rose to 1.3 per cent. This is a welcome increase according to Mr Flodén. He however shares the assessment in the draft Monetary Policy Report that underlying inflation will remain at about the same level for a few more months and will then only rise slowly towards 2 per cent over the following year. Furthermore, one precondition for this rise in inflation is the continued strong development of resource utilisation, which, in turn, requires a continued expansionary monetary policy. This is reflected by the forecast for the repo rate in the draft Monetary Policy Report, in which slow increases from the current level will not begin until the start of 2018.

As inflation has now been clearly below the inflation target for many years – exactly seven years if inflation is measured using the CPIF excluding energy – the Riksbank must ensure that inflation is really continuing to rise and that it becomes established on a level that complies with the inflation target. Otherwise, the risk is that inflation expectations will again start to fall and confidence in the inflation target will be lost. Such a development could, for example, lead to long-term nominal interest rates becoming stuck at a very low level.

It is unusual for monetary policy to have to be expansionary when resource utilisation is strong and is expected to rise further. The foremost risk usually associated with the combination of strong resource utilisation and expansionary economic policy is that prices and wages start to rise in an uncontrolled fashion. It is important to point out that we have not seen any such tendencies in the Swedish economy yet, said Mr Flodén. He repeated that the monetary policy the Riksbank is now conducting is expected to lead to a slow rise in inflation. The high level of resource utilisation is hardly a substantial problem in itself either. Resource utilisation has been low for large parts of the period following the outbreak of the financial crisis and unemployment is still clearly higher than prior to this period. It is conceivable that a high level of resource utilisation is necessary to push up the economy's production capacity, for instance by facilitating for vulnerable groups to become established on the labour market.

Mr Flodén went on to note that the most substantial risk associated with the low policy rate is the development of the housing and mortgage markets. But this is a sector-specific trend and is best managed through targeted measures. Finansinspektionen, the Government and the Riksdag hold the tools that can solve the underlying problems on these markets in the long run. They also hold the tools that can best counteract the continued build-up of risks in the short run, said Mr Flodén. His assessment is that a tighter monetary policy in the near future, when inflationary pressures are still too low, would hardly lead to a lasting improvement of the risk outlook, but would instead risk extending the period of low interest rates.

Mr Flodén also wished to again point out that monetary policy is not as expansionary as the low interest rates may suggest if it is compared with a historically normal policy rate. As the Riksbank has pointed out many times, and as is discussed in an article in the draft Monetary Policy Report, the underlying interest rates have fallen by several percentage points in recent decades. In addition, monetary policy is expansionary abroad. The Swedish policy rate must be judged in relation to the underlying interest rates and international monetary policy.

Mr Flodén repeated that the development of the economy had been roughly in line with the forecast made at the previous monetary policy meeting. However, the international political uncertainty has increased. In the United States, for example, this concerns trade and security policies, the focus of economic policy and the regulation of financial markets. And, in Europe, uncertainty over the development of the European Union is increasing. Mr Flodén said that these issues may have major consequences for the development of the global economy, and thus the Swedish economy, in the period ahead, but nevertheless he saw no clear implications of this uncertainty on today's monetary policy decision.

The most substantial deviation from the Riksbank's economic forecast in December is that the krona has become several per cent stronger than in that assessment. However, this krona appreciation must be seen in the light of the sharp depreciation that the krona underwent in the autumn. Despite this appreciation, the Swedish exchange rate cannot be described as strong at present, according to Mr Flodén, who also explained that he does not regard recent developments as an obstacle to the continued rise of inflation. However, a continued appreciation at the same rate would hardly be desirable, said Mr Flodén. Despite this, he did not support the meeting's proposal to extend the mandate facilitating a quick intervention on the foreign exchange market. His argument for this is the same as it was for the earlier decisions taken in January, February and July 2016.

Mr Flodén otherwise supported the proposed decisions at the meeting, which is to say the decision to hold the repo rate unchanged at −0.50 per cent, the economic forecast and the draft Monetary Policy Report. But he wished to point out that the probability of a repo rate cut at the next monetary policy meeting, implied by the proposed interest rate path, is much too high to reflect his view of which monetary policy will then be appropriate, just as it was at the meetings in October and December. It would take a major change in economic developments or the assessment of inflationary pressures to get Mr Flodén to advocate a changed repo rate at the next meeting.

Governor **Stefan Ingves** opened by noting that the changes to the Riksbank's forecast have been minor and, in his opinion, it is therefore most appropriate to leave monetary policy essentially unchanged. The international recovery is proceeding at a moderate pace and a number of positive indicators have come in since the last forecast was made in December 2016. However, at the same time, increased political uncertainty has increased the risk of setbacks. There is also considerable uncertainty over the design and effects of economic policy in many countries.

The US president has announced extensive fiscal policy stimulus measures, but it is as yet unclear how they will be formulated. The effects on growth and public finances remain to be seen. The effects of a more expansionary fiscal policy would seem partly to be counteracted by increased protectionism, something which will almost certainly be a disadvantage for Sweden. The United Kingdom's decision to leave the EU and the elections to be held in France, the Netherlands and Germany in 2017 are also contributing to the political uncertainty abroad.

A number of positive economic signals have been received from the euro area, but the adjustment of imbalances after the financial crisis has been slow. Banks in several countries have weak profitability and a large proportion of non-performing loans. Many banks are also poorly capitalised. If these problems are exacerbated, credit granting in Europe will risk being tightened, inhibiting the recovery that is on the way. This is also contributing to risks for continued weak rule compliance on the national level, as regards both macroprudential policy and fiscal policy, Mr Ingves pointed out.

In the Swedish economy, the overall picture remains, with strong economic activity that is expected to continue to improve in the years ahead in the main scenario. But of course the international risks, not least the political ones, may change that assessment. The increasingly strong level of economic activity is contributing towards the conditions for the inflation target to be reached in 2018. CPIF inflation has shown a rising trend since 2014. Recently, energy and food prices have turned upwards, but underlying inflation remains low. Stronger economic activity should contribute towards companies finding it easier to raise prices on their products at the same time as their costs gradually rise more rapidly.

Another factor that affects inflation is the krona exchange rate, Mr Ingves continued. During much of 2016, the krona was weaker than in the forecasts, although it has been stronger than expected since December. In the period ahead, the krona is expected to appreciate slowly as the economy recovers. For the upturn in inflation, it is important that this appreciation really is slow. If the krona strengthens too rapidly, it may lead to prices of imported goods and services increasing more slowly and to a decline in the demand for Swedish exports. Such a development would make it more difficult to bring up inflation.

Inflation measured in terms of the CPIF and the CPIF excluding energy is not expected to stabilise at around 2 per cent until the end of 2018. Now, at the start of 2017, there are several factors that are restraining the development of inflation. Changes in taxes and subsidies are expected to contribute less to the rate of increase in the CPI in 2017 than in 2016. In addition, some prices that increased more than usual in December, including domestic air travel prices, are expected to fall back in the early part of the year. Together, this is contributing towards inflation being expected to move sideways for some time to come. This movement is an important component in monetary policy this time.

According to Mr Ingves, the overall view suggests that monetary policy needs to continue providing strong support for inflation to rise towards 2 per cent. Inflation has been low for a long time and is still not lastingly close to the inflation target.

Furthermore, Mr Ingves said that the unease he felt in the autumn over the way that monetary policy abroad is moving in different directions very much remains. The Federal Reserve left monetary policy unchanged in February after having increased the interval for its policy rate by 0.25 percentage points to 0.50–0.75 per cent in December. The ECB decided in December to increase its bond purchases by EUR 60 billion per month from April until the end of December 2017. At the meeting in January, monetary policy was left unchanged. It will be a long time before the ECB starts to normalise monetary policy. Monetary policy is moving in different directions in the United States and euro area, which is naturally contributing to a certain amount of tension, as the Riksbank's monetary policy must consider the monetary policy conducted by both the Federal Reserve and the ECB.

This also means that the risk of an excessively rapid appreciation of the krona remains. In this situation, Mr Ingves considers it to be a risky strategy for a central bank in a small, open economy such as Sweden’s to more tangibly start to normalise monetary policy ahead of the central bank of a large currency area like the ECB. To sum up, this argues for not rocking the boat and holding to the course of monetary policy decided in December. Monetary policy needs to continue to be highly expansionary, said Mr Ingves, and expressed his support for the proposed repo rate path and the proposal to hold the repo rate unchanged at −0.50 per cent.

Furthermore, Mr Ingves said that the Executive Board should take the decision at the day's meeting to extend the mandate facilitating quick intervention on the foreign exchange market. This could be justified by the great uncertainty prevailing over the krona exchange rate and its effect on inflation. The purchases of government bonds will continue for the first six months of 2017, as was decided in October. It is also reasonable to reinvest maturities and coupon payments on the government bond portfolio, according to Mr Ingves. Over the year, these maturities and coupon payments will amount to around SEK 30 billion and reinvestments are planned to continue until the end of the year.

Mr Ingves went on to express his support for the proposed new assessment of the interval for the repo rate five to ten years ahead. This long-term interest rate has fallen due to several factors described in an article in the draft Monetary Policy Report. It is now expected to be between 2.5 and 4.0 per cent, which is lower than the previous interval of 3.5–4.5 per cent. The new interval also corresponds with the assessments made by other central banks of international long-term rate levels. For a small, open economy like Sweden's, the long-term interest rate is greatly affected by international events. But it can also be affected by domestic economic imbalances, which can push the interest rate above international ones. It is therefore difficult to know, with any great degree of precision, what level the repo rate will actually have in five to ten years. The proposed interval assumes that the domestic economy is more or less balanced, something which is difficult to predict so far ahead.

Finally, Mr Ingves repeated once again that the Swedish housing market continues to be highly valued from a historical perspective. Annual credit growth among households continues to be high and amounted to 7.2 per cent for bank loans, while housing prices increased by 8.6 per cent on an annual basis in December. High housing prices and households' increasing indebtedness entail very high risks for economic and financial stability, as the Riksbank and international organisations such as the European Systemic Risk Board (ESRB) and IMF have warned. Measures are still needed within the fields of macroprudential policy, housing policy and tax policy to limit the build-up of debt in the household sector and to improve the functioning of the Swedish housing market. Without such measures, there is a risk to long-term economic stability in Sweden, with a risk of spillover effects to our neighbouring countries.

First Deputy Governor **Kerstin af Jochnick** opened by saying that she supports the assessments in the draft Monetary Policy Report and that she also supports the proposal of holding the repo rate at −0.50 per cent. She also shares the assessment of the repo rate path and that there is a greater probability that the repo rate will be cut in the near term than that it will be raised. Finally, she supported the extension of the foreign exchange intervention mandate.

As had previously been mentioned at the meeting, an overall assessment of developments in recent months, both abroad and in Sweden, suggested that most indicators were developing in line with the Riksbank's forecasts. In Sweden, confidence in the Swedish economy is high among both households and companies.

Employment has developed strongly and we are seeing shortages in several sectors, which suggests that the rate of wage increases will rise over the forecast period. However, the labour market is divided. For those groups described as vulnerable in the statistics, unemployment is significantly higher than it is for others, Ms af Jochnick pointed out. The Economic Policy Council of the Swedish Centre for Business and Policy Studies sheds light on this issue in a good way, she said. This is the central problem that Sweden needs to develop measures to address. The faster these vulnerable groups can be included in employment, the better it will be for society and future growth in Sweden.

Assessments and forecasts one and two years ahead are always uncertain. As the draft report mentions, and as several of her colleagues have brought up at the day's meeting, it is not possible as yet to confidently assess in which ways the changed policies of the United States and the United Kingdom's withdrawal from the EU will affect world trade and interest rates over the short and long term. It is clear that Sweden will be affected but it is difficult to quantify the effects of this political uncertainty on the economy. The impact of US and British policy on global trade and interest rates must continue to be analysed, as must their possible effects on Sweden's foreign trade, exchange rate and, ultimately, GDP growth and inflation, continued Ms af Jochnick. To this can be added the problems in Europe not just regarding the uncertain outcome of upcoming elections in several countries but also regarding the ability to restore the European banking sector to a good condition and to find solutions for the countries that are continuing to struggle with problems arising from the sovereign debt crisis.

Inflation is slowly developing in the right direction. There are some who wonder why the Riksbank is not satisfied with the development of inflation, considering that the outcome for CPIF inflation in December was 1.9 per cent. However, Ms af Jochnick's assessment is that underlying inflation is not yet on a firm footing. In the Riksbank's forecasts, several factors are considered to be restraining inflation in the first quarter of 2017. Inflation does not look like it will stabilise around 2 per cent until well into 2018. One factor that suggests higher inflation over the forecast period is the continued rise in resource utilisation in the economy, said Ms af Jochnick. This is contributing towards making it easier for companies to raise the prices of their products.

The krona exchange rate is also important for inflation. In the period ahead, the Riksbank expects the krona to appreciate slowly as the economy recovers. It is important that this appreciation is slow, said Ms af Jochnick. If this should happen too rapidly, it may lead to import prices increasing more slowly and to a lower demand for Swedish exports. This would make it more difficult to bring up inflation.

One lesson that Ms af Jochnick thinks can be learned from recent years is that the Riksbank has assessed, on several occasions, that inflation would reach 2 per cent over the following year but has then had to revise these assessments for many different reasons. Unlike previously, long-term inflation expectations since mid-2016 are now back close to 2 per cent, which is positive. This should also create the conditions for the inflation target of 2 per cent to remain a benchmark for price and wage formation in Sweden.

All in all, Ms af Jochnick considers that there are strong indications that inflation will stabilise around 2 per cent in 2018. However, for inflation to stabilise around 2 per cent, economic activity needs to remain strong, international demand for Swedish goods and services need to increase, and the krona should not appreciate too rapidly. Even though the assessment is that inflation will stabilise around 2 per cent in 2018, this assessment is surrounded by a number of uncertainty factors. According to Ms af Jochnick, it is therefore important to maintain the expansionary monetary policy and to be prepared to use the tools the Riksbank always has at its disposal to make monetary policy more expansionary.

In its most recent economic survey of Sweden, the OECD repeats that household indebtedness is contributing towards making the Swedish economy vulnerable. The measures proposed by the OECD are aimed at improving both the housing market and indebtedness. The proposed measures are well in line with the Riksbank's previously stated proposals, Ms af Jochnick pointed out. Even if the development of housing prices seems to have slowed down slightly and even if housing investments are high at present, her assessment is that efforts so far in this area are insufficient. It therefore continues to be thoroughly essential that measures are taken that will contribute towards a long-term improvement by streamlining the housing market and achieving a better balance between supply and demand, at the same time as incentives to incur debt are restrained. As the OECD points out, the housing market and household indebtedness form an obvious risk for the growth of the Swedish economy further ahead, continued Ms af Jochnick. The high proportion of mortgage loans at variable interest rates also means that higher interest rates will rapidly impact on a large part of the mortgage stock. Experiences from other countries suggest that a high level of indebtedness often worsens economic slowdowns.

Deputy Governor **Cecilia Skingsley** began by supporting the Monetary Policy Report, its forecasts, considerations and draft monetary policy decision.

Since the December meeting, the challenges for the monetary policy analysis have increased, Ms Skingsley continued. On the one hand, the economic data has largely developed as expected compared with the Riksbank's previous forecasts, while on the other hand her view was that the uncertainty surrounding future economic development has increased. In her contribution, she wished to comment on two circumstances that are central to her stance: the course of inflation and conditions abroad. In addition, she wished to comment on the scope for using monetary policy to subdue financial imbalances.

Ms Skingsley began with the course of inflation, stating that CPIF inflation rose to 1.9 per cent in December. Bearing in mind that this is the highest reading for this measure since 2010, she sees the outcome as a welcome sign that the very expansionary monetary policy of recent years has had an effect on inflation. At the same time, she noted that the CPIF excluding energy has not shown the same clear increase, as this measure of inflation was recorded at 1.35 per cent in December. Thus, the upturn in inflation over recent months is largely the result of the growth in energy prices. If we look at the indicators of underlying inflation, the picture is still benign. But in the next few months, inflation is expected to turn slightly downwards, regardless of which measure is used. Even though the Riksbank is gradually succeeding to return inflation to target and inflation expectations are continuing to show a rising trend, she makes the assessment that inflation still demands the vigilance of the Executive Board.

As regards conditions abroad, Ms Skingsley wished to point out that the new political leadership in the United States has increased uncertainty over important political choices in the period ahead. Decades of international efforts aimed at reducing the economic significance of national borders are being brought into question and reforms towards a more inward-looking economy have started. The course of events in the United States, whereby the centres of power, the legislative, the executive and the judicial institutions, are interacting with each other about the new policy, is a form of ongoing stress test of the form of government in the world's largest economy.

Ms Skingsley also noted that it looks like we are witnessing a chain of events that can neither be captured in the forecasting models nor considered in the Riksbank's near-term monetary policy. As a small, open economy, however, it is important to consider possible scenarios and consequences for Sweden. An environment with less political predictability can give rise to several different economic events. The volume of activity in specific sectors can be affected in the short run or more structurally. The risk premium for different types of enterprise may increase. In the US, a more expansionary policy can drive forward growth and inflationary pressures in the short run, but also ultimately cause difficulties for public finances. It is still uncertain what will materialise. Therefore, her assessment was that it was reasonable not to make any excessive forecast adjustments this time. However, this may become relevant later on.

She pointed out that the international course of events once again underlines the importance of a small economy acting in a way that maintains its ability to be flexible and resilient. The Swedish economy is continuing to develop strongly. Confidence indicators are still high and rising and the growth forecast has been revised upwards slightly in the near term. Against the backdrop of uncertainty abroad, however, the Riksbank also needs to be prepared for a less positive development. The krona exchange rate constitutes one of the more rapid channels for fluctuation. Since the December meeting, the krona has appreciated more than expected. This is partly due to better economic data. But it is still important that the development of the krona does not jeopardise what monetary policy has achieved in terms of improved resource utilisation and inflation. Ms Skingsley therefore supported the current interest rate path and the extension of the foreign exchange intervention mandate. She backed the mandate as she feels that it is still important to be prepared to take fast action if the krona development threatens fulfilment of the inflation target.

In conclusion, Ms Skingsley wished to broach a subject that is regularly discussed: the use of monetary policy to subdue financial imbalances. In Sweden, the issue is most relevant as regards the expansion of credit in the household sector. But the debate on the role of monetary policy vis-à-vis financial imbalances is international and has been ongoing for decades. The debate has also focused on other sectors, especially the role of monetary policy for the commercial property market and the equity market.

As far as the Riksbank is concerned, she noted that there is a lack of guidance in the preparatory works to the current Sveriges Riksbank Act from 1999 and that, at this point, there are quite a few executive board members, including herself, who have struggled with the issue of monetary policy and financial imbalances. She pointed out that she herself had said on previous occasions that monetary policy can help to limit financial imbalances. She noted, however, that this can only be done as long as it does not jeopardise the core task, i.e. pursuing monetary policy in order to reach 2 per cent inflation within a reasonable period of time.

The differences of opinion inside and outside the Riksbank have been considerable, especially in terms of the number of Executive Board reservations and media analyses during the years 2011 to 2014. According to Ms Skingsley, the prevailing lack of clarity both in terms of mandates and decisions has damaged the Riksbank’s reputation. She therefore sees it as a welcome development that the forthcoming Riksbank inquiry will consider whether monetary policy should take factors such as asset prices and the functioning of the financial markets into account. She noted, however, that it will take over two years for the inquiry to complete this important work. In the meantime, the Riksbank, along with other parties responsible for maintaining financial stability, including the Ministry of Finance, Finansinspektionen and the National Debt Office, have to manage the ongoing build-up of debt. Just as she has expressed previously, she is worried about the poorly functioning housing market and about the unclear procedure for macroprudential policy decisions in Sweden.

The Executive Board of the Riksbank has called for a consolidated approach across several policy areas. She therefore welcomed the call by the Finansinspektionen executive for measures to be taken in other policy areas besides its own tools. The fact that there is a request for the Riksbank’s monetary policy to consider household indebtedness is a notable example. At present, when inflation development is still fragile, Ms Skingsley considers rate rises as a method to reduce the rate of indebtedness to be a less feasible option. She noted, however, that this is an issue that will crop up again.

Deputy Governor **Per Jansson** began by noting that one new outcome has been published for inflation and inflation expectations respectively since the monetary policy meeting in December. The inflation outcome that related to December, reported a CPIF inflation rate of 1.94 per cent. The outcome was 0.10 percentage points higher than the Riksbank's forecast and the highest for six years. Inflation expectations, according to Prospera's monthly survey of money market participants in January, rose on all surveyed time horizons. Two years ahead, expectations are now only just over a tenth of a percentage point below the inflation target of 2 per cent. And the important expectations of inflation five years ahead, which can be regarded as a measure of the credibility of the inflation target, amounted to 2.01 per cent. This is the highest reading for five-year inflation expectations among money market participants since November 2013. And to find a similarly high outcome for expectations two years ahead, one has to go back even further in time, to April 2012.

With these figures in mind, surely the Riksbank should now be able to draw the conclusion that the inflation battle has finally been won and that it is time to focus more on when and how to start tightening monetary policy, he continued. This is also the conclusion increasingly drawn in the public debate and the reporting on the Riksbank's monetary policy. But as Mr Jansson sees it, it is too early to draw this conclusion and also risky to do so. In what follows, he wished to expound on the reasons why he considers this to be the case.

Perhaps the most important reason is that more underlying, demand-related inflation is still quite conspicuous in its absence. Although CPIF inflation was only a few hundredths of a percentage point lower than the inflation target in December, much of the price increase was explained by temporary effects from rising energy prices. Excluding energy prices, CPIF inflation amounted to a modest 1.35 per cent. And even if this outcome too was slightly above the most recent forecast, the major contribution from energy prices illustrates that there is still some way to go before one can be satisfied, Mr Jansson emphasised. The Riksbank expects the contribution from energy prices to decrease in the months ahead causing CPIF inflation to fall back visibly. Not until mid-2018 will inflation in terms of both the CPIF and the CPIF excluding energy approach 2 per cent in a more sustainable way. The Riksbank's conclusion is that continued strong economic activity is required in the years ahead for inflation to stabilise around 2 per cent. The fact that indicators of economic activity are now pointing upwards is a good start, but is not enough to set our minds at rest. The conclusion drawn by Mr Jansson was that it is quite clear that we don't have inflation conditions that give the Riksbank any reason to start celebrating.

In this situation, focusing too much on CPIF inflation may prove particularly problematic if it leads to an appreciation in the krona exchange rate, he said. Neither does he think that it is currently a good idea to celebrate expected good future economic developments in advance in the form of a stronger krona exchange rate already here and now. In recent years, inflation has repeatedly surprised on the downside and a precautionary principle should therefore be applied. Only when it really can be verified that economic activity is having an impact on inflation will a gradual appreciation in the krona be justified. And we are not there yet. In this perspective, according to Mr Jansson, the krona exchange rate has strengthened far too much recently as the more underlying inflation rate, measured in terms of the CPIF excluding energy, has only shown a weak increase.

A related aspect to the krona's recent development has to do with the market reactions following the Executive Board's monetary policy decision in December. Many have speculated that the reservations from several Board members against further purchases of government bonds were a contributory factor to the relatively strong increase in the value of the krona. The fact that the minutes from the meeting then showed that these Executive Board members were also sceptical to the forecast of the repo rate in the near term, which implied rather a high likelihood for a further rate cut, has also been pointed out as a reason for continued appreciation of the krona exchange rate. Mr Jansson said that he was unable to comment on whether this is true or not. But if it is true, there is, in his opinion, every reason to consider the market reactions after the December decision to be clearly exaggerated. After all, a majority of three members, provided that the Governor of the Riksbank is one of them, is able to take exactly the same decisions as a unanimous board without any reservations, he observed. And Mr Jansson emphasised that it was his perception that there was a clear consensus among the majority, to which he belonged, regarding the decision in December, and that they were also in agreement as regards continuing on the present course until inflation is on firm ground.

Another important reason why the Riksbank is not done yet and cannot start to focus on tightening monetary policy is, according to Mr Jansson, the considerable and rising level of political uncertainty in several parts of the world. The increasing uncertainty is evident from, for instance, interest-rate and exchange-rate developments in the United States and Europe. This is discussed in more detail in the draft Monetary Policy Report. He pointed out that the likelihood of one of the various risks giving rise to a very negative scenario is probably small but that the consequences could be dramatic and create an entirely new situation if it were to happen. A wave of protectionism sweeping through large parts of the global economy is unfortunately not an impossible scenario, for example. Central banks would naturally have limited scope to counteract such a development and inflation prospects would hardly be the greatest economic concern in such a situation. But political uncertainty can also lead to shocks that are not quite so dramatic and where central banks have a clearer role. For example, one can imagine households and companies starting to worry about future developments and, as a result, reduce their consumption and investment. Regardless of whether the shocks were more or less dramatic, Mr Jansson found it less appropriate under present circumstances to consider monetary policy tightening in a small, very trade-dependent economy like Sweden. In this situation, you quite simply want to wait until the fog has lifted, he reasoned.

In summary, Mr Jansson believed that now is not the time to start celebrating prematurely, even if CPIF inflation is very close to 2 per cent and the inflation target enjoys full credibility. The time to focus more on when and how to start tightening monetary policy will, as he sees it, not be until the more underlying inflation rate clearly approaches the inflation target and political uncertainty abroad subsides. As long as this does not happen, there continues to be, in his view, a greater probability of the next monetary policy move being a loosening rather than a tightening.

Against this backdrop, and in light of the decision already taken to continue the purchases of government bonds in the first half of 2017, Mr Jansson considered it a good idea to retain the relatively large likelihood of a further cut in the repo rate in the near term, just as is proposed in the draft Monetary Policy Report. He also thought it was good to take the decision now to extend the mandate facilitating quick intervention on the foreign exchange market. The extension of the mandate, until October 2017, is justified by the major uncertainty surrounding the development of the krona exchange rate and the consequences this may have for inflation. With this, Mr Jansson also supported both the forecast and the monetary policy presented in the draft Monetary Policy Report. He pointed out, however, that the difficult monetary policy situation at present, with considerable political uncertainty in many parts of the world that risks becoming entrenched for quite a long time, may require the Executive Board, at its upcoming meetings, to consider slightly postponing when to start raising the repo rate.

Deputy Governor **Henry Ohlsson** began by saying that he supported the proposal to hold the repo rate unchanged at −0.50 per cent. He then noted that the outcomes for important 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.

The most recent inflation figures in December showed an annual rate of increase for the CPIF of 1.9 per cent. Inflation is thus close to the inflation target. The January reading of five-year inflation expectations among money market participants was 2.0 per cent. In both 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. GDP growth in Sweden is rapid. According to the Monetary Policy Report, calendar-adjusted GDP will grow by 2.7 per cent in 2017. This is slightly lower than growth in 2016 but still high historically speaking.

Mr Ohlsson also noted that the Labour Force Surveys (LFS) continued to show falling unemployment; in December 2016 the unemployment rate was 6.5 per cent (not seasonally adjusted). This is lower than the same month last year. According to him, however, unemployment is still on too high a level. The differences between various groups are also becoming increasingly clear; the division is growing. Those born in Sweden have a much better labour market situation than those born abroad. One group that can be considered to have a relatively strong position on the labour market is unemployment insurance fund members. He noted that the proportion of openly unemployed insurance fund members was 2.6 per cent in January and that the figures came the day before the meeting. This is 0.3 percentage points lower than the same month one year earlier. This decrease must be considered significant as these statistics are composite. The percentage of openly unemployed fund members is now lower than it was before the financial crisis.

In addition, he noted that the National Institute of Economic Research's Business Tendency Survey indicates a growing labour shortage. The number of vacant positions is increasing according to statistics from both Arbetsförmedlingen (the public employment agency) and Statistics Sweden. Here, said Mr Ohlsson, it is important to point out that a vacant position does not necessarily mean that the working task is not being performed. Only about 40 per cent of vacant positions are actual job vacancies. In other cases, the working tasks are performed by substitutes, staffing agencies and the like.

The conclusion from the real indicators is that overall resource utilisation in the Swedish economy has now passed normal levels and can be expected to rise even higher in the coming years. This in itself is not necessarily a restriction for current monetary policy. In the prevailing economic situation, when inflation is below target, there is no conflict of interests between real economic activity and inflation, according to Mr Ohlsson.

The fact that inflation is still sub-target calls for continued expansionary monetary policy. But, he asked himself, are even more expansionary monetary policy measures required? Regarding today's monetary policy decision, it is firstly a question of what can be done. Here, according to Mr Ohlsson, although it is possible to make monetary policy more expansionary, the more important question is what it is desirable to do with monetary policy. Here, one has to weigh up the advantages and disadvantages of different monetary policy options. His monetary policy conclusions at the meeting are that the repo rate should be held unchanged. With regard to the repo-rate path, he thinks that it should continue to be formulated so that increases in the repo rate will begin in early 2018.

The difference between the current repo-rate path and the minimum repo-rate path is interpreted by many to be a measure of the probability of the repo rate being cut in the future. Here, he thought that the repo rate path should be formulated so that this probability is on the same level as in the repo rate path decided at the September meeting and lower than at the monetary policy meetings in October, December and in today's draft Monetary Policy Report. However, he did not want to enter a reservation on this point.

Finally, he wished to say that he supports the proposal to extend the mandate for foreign exchange interventions.

Governor **Stefan Ingves** then summarised the discussion. He noted that the Executive Board agreed on the outlook for economic development and inflation described in the draft Monetary Policy Report.

Since the last monetary policy meeting in December, outcomes and indicators have confirmed the Riksbank's view of an economic recovery abroad and strong economic activity in Sweden, and the revisions in the forecasts are largely minor. At the same time, political uncertainty is considerable in many parts of the world and the risks of setbacks have increased.

It is pleasing that economic activity is strong in Sweden and that inflation expectations are now back in line with the inflation target. CPIF inflation in December was also close to 2 per cent, but it is important to point out that the recent upturn has been mostly driven by temporary factors. It is the assessment of the Executive Board members that it will not be until the end of 2018 before inflation stabilises around 2 per cent.

Inflation has been low for a long time and continued strong economic activity and a krona that does not appreciate too rapidly are required for inflation to sustain itself on a level close to the inflation target. Political uncertainty abroad, which can ultimately have a negative impact on the development of Swedish economic activity and inflation, also underlines the need for monetary policy to remain expansionary.

All members deemed it appropriate to hold the repo rate at −0.50 per cent. Opinions differ slightly in the Executive Board as to the exact formulation of the repo rate path but all the members support the repo rate forecast. This forecast reflects the fact that there is still a greater probability that the rate will be cut than that it will be raised in the near future, and that slow increases will not begin until the start of 2018.

Moreover, a majority of members considered it appropriate to extend the mandate facilitating rapid intervention on the foreign exchange market, against the backdrop of the major uncertainty that prevails regarding the development of the krona exchange rate and the consequences it may have for inflation. One member did not support this proposal.

Purchases of government bonds will continue according to the plan adopted in December.

Aspects of the risks associated with the growing household indebtedness were also discussed at the meeting. The Executive Board is in agreement that these risks need to be managed using targeted measures in housing policy, tax policy and macroprudential policy.

§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. Other decisions

The Executive Board decided

• to publish the Monetary Policy Report and decisions under Section 3 at 09.30 on Wednesday 15 February 2017 with the motivation and wording contained in a press release, and

• to publish the minutes of today's meeting on Wednesday 1 March 2017 at 09.30.

Sections 3 and 4 were verified immediately.

Minutes taken by

Sophie Brauner

Verified by:

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

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