Monetary policy minutes

February 2018

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

Summary

At the Monetary Policy Meeting on 13 February 2018, the Executive Board of the Riksbank decided to hold the repo rate unchanged at –0.50 per cent. The forecast for the repo rate is unchanged since December and indicates that slow repo rate rises are set to be initiated during the second half of this year. Reinvestments of redemptions and coupon payments in the government bond portfolio will continue until further notice.

A majority of the Executive Board supported the picture of the economic outlook and inflation prospects described in the draft Monetary Policy Report. Economic activity abroad continues to strengthen and in Sweden, growth is high, the labour market is strong and inflation is close to the target of 2 per cent.

But the inflation forecast has been revised down slightly for the year ahead as a result of weaker-than-expected inflationary pressures and wages developments. It was noted that a necessary condition for inflation to stabilise close to 2 per cent is that monetary policy remains expansionary.

Several members expressed concern over the development of inflation in the period ahead and emphasised that downside risks need particularly close attention when determining the appropriate timing and speed at which to initiate rate rises. The importance of monetary policy proceeding cautiously was emphasised in light of the length of time it has taken to bring inflation and inflation expectations back to 2 per cent. It was noted that the relationship between monetary policy in Sweden and abroad plays a central role as it influences the development of the exchange rate and hence the economic outlook and inflation prospects in Sweden. Developments in the housing market also continue to be important to follow.

Several members also pointed out the importance of inflation expectations continuing to be in line with the inflation target. Confidence in the inflation target has strengthened, but there is a risk that it has still not been completely restored after the earlier long period of low inflation. If inflation expectations were once again to fall, it would make it more difficult for the Riksbank to stabilise inflation going forward.

One member entered a reservation against the decision to hold the repo rate unchanged and against the repo-rate path in the Monetary Policy Report. He advocated an increase in the repo rate to –0.25 per cent, referring to the strong economic development in Sweden and internationally and that inflation and inflation expectations have been close to 2 per cent for some time.

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MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 1

DATE: 13 February 2018.

TIME: 09:00

PRESENT: Per Jansson, chair
Stefan Ingves, participated by telephone
Kerstin af Jochnick, participated by telephone
Martin Flodén
Henry Ohlsson
Cecilia Skingsley

Michael Lundholm, Vice Chairperson of the General Council

Meredith Beechey Österholm
Charlotta Edler
Paul Elger
Lena Eriksson
Mattias Erlandsson
Eric Frieberg
Anders Gånge
Kerstin Hallsten
Jesper Hansson
Henrik Jönsson
Maria Kindborg
Ola Melander
Pernilla Meyersson
Ann-Leena Mikiver
Marianne Nessén
Amanda Nordström (§ 1-3A)
Bengt Petersson
Carl-Fredrik Pettersson (§ 1-3A)
Maria Sjödin
Ulf Söderström
Fredrik Wallin (§ 1-3A)
Anders Vredin

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

§1. Economic developments

Market developments since the last monetary policy meeting

Carl Fredrik Pettersson of the Markets Department began by presenting the latest developments on the financial markets. Since the monetary policy meeting in December, there has been an upward shift in monetary policy expectations and bond yields abroad. According to market pricing, a first rate rise from the European Central Bank (ECB) is expected during the first half of 2019. The rate rise is expected after net asset purchases are concluded which will be at some point between the beginning of September and the end of December this year according to market surveys. In the United States, incoming macro statistics have generally been strong, contributing to a rise in both inflation expectations and the market's expectations of the US central bank's (Federal Reserve's) policy rate. According to market pricing, three rate rises in the US are expected this year and one more next year. In the United Kingdom, the Bank of England has revised up the forecast for GDP growth in its latest inflation report and its communication indicates a move towards a less expansionary monetary policy going forward. The turbulence and downturn on global equity markets at the beginning of February, which owed partly to unexpectedly strong wage statistics in the US, have not been a source of concern in the communication from these central banks.

Prior to today's monetary policy decision, it is assumed that the repo rate will be left unchanged. Market expectations regarding the timing of an initial interest rate increase from the Riksbank have been brought forward slightly. The average of market assessments is that this will occur at some point during the third quarter of this year. Most analysts expect an unchanged interest rate path and of those who anticipate a changed interest rate path, a majority expect the path to rise. In competition-weighted terms, the Swedish krona is relatively unchanged compared with at the time of the monetary policy meeting in December. The krona strengthened immediately after the meeting but then weakened slightly during the stock market turbulence. Unease over developments on the Swedish housing market has decreased. The mortgage bond market is stable. Mortgage bond yields rose only marginally in relation to government bond yields in connection with the stock market turbulence.

The current monetary policy drafting process – new data and forecasts

Jesper Hansson, Head of the Monetary Policy Department, began by presenting the forecast that the Monetary Policy Department judged would gain the support of the majority of Executive Board members. The monetary policy drafting process has included discussions with the Executive Board regarding the forecasts and the monetary policy assumptions at meetings on 1, 2 and 5 February. The draft Monetary Policy Report was discussed and tabled at a meeting with the Executive Board on 7 February.

Mr Hansson then summarised the new information received since the monetary policy meeting in December. Regarding developments abroad, growth is good, but underlying inflationary pressures are still moderate. Expectations of future policy rates abroad have risen slightly since December as a result of a continued good economic outlook and communication from some central banks. There has been high volatility on equity markets recently, which is probably due to the higher expectations regarding interest rates going forward. In the Swedish economy, growth indicators point to continued strong development at the end of 2017 and beginning of 2018. In line with expectation, housing prices continued to fall slightly in December. At the same time, inflation and wage growth were slightly lower at the end of last year. CPIF inflation in December was 1.9 per cent, a tenth of a percentage point lower than the forecast in the Monetary Policy Report in December. Short-term wages are judged to have increased by 2.5 per cent for the whole of 2017, which is lower than the assessment of 2.7 per cent in the December forecast.

Mr Hansson noted that GDP abroad continues to increase at a good pace and that the changes are minor in the forecast since December. Despite a good economic outlook, inflationary pressures are only rising slowly. Rising energy prices imply that aggregate inflation is higher and will rise more quickly in 2018. Regarding monetary policy, the ECB decided to leave policy rates unchanged in January. Net asset purchases are continuing in accordance with the earlier plan, which means that the rate of asset purchases has been lower since the turn of the year. The Federal Reserve also left the policy rate unchanged at its latest meeting in January and the tapering of its asset holdings, initiated in October last year, is continuing. The forecast for policy rates abroad has been revised upwards slightly, although only cautious rate rises are still expected in the years ahead.

Regarding the Swedish economy, Mr Hansson noted that monthly output statistics and confidence indicators suggest that growth will continue to be high some way into 2018. Growth will then slow as housing construction declines and growth on the export market subsides. The forecast for GDP growth has been revised marginally downwards for 2018 as the decline in housing construction is now expected to occur slightly more rapidly than in the December forecast. Unemployment has fallen quite slowly in recent years. Unemployment is only expected to fall slightly further, to 6.4 per cent in 2018. Companies are reporting major labour shortages, but matching problems remain and recruitment times are long. New outcomes for inflation and wages suggest that underlying inflationary pressures are slightly lower than in the assessment in December. The forecast for CPIF inflation has therefore been revised down by two tenths of a percentage point for 2018 and one tenth for 2019. Rising resource utilisation both in Sweden and abroad is contributing with a slight time lag to higher inflation and CPIF inflation is expected to be close to target from 2019 onwards.

Mr Hansson emphasised that the forecasts presented in the draft Monetary Policy Report are based on the monetary policy that is expected to gain a majority at today’s monetary policy meeting. This means that the repo rate is left unchanged at –0.50 per cent at today's meeting. The forecast for the repo rate is unchanged since December and indicates that slow rate rises are set to be initiated during the second half of this year. At the end of January, the Riksbank's government bond holdings amounted to just over SEK 310 billion, expressed as a nominal amount. The macro forecast presupposes the reinvestment of redemptions and coupon payments at an even rate going forward in accordance with the decision in December.

Mr Hansson then highlighted two important questions that have been the subject of particular discussion in the monetary policy drafting process in February. The first concerns underlying inflationary pressures in Sweden. Inflation was slightly lower than expected in December. It is not a major deviation, but the rate of increase in service prices, excluding volatile prices for foreign travel, has declined in recent months. This raises questions about underlying inflationary pressures. At the same time, new figures for short-term wage statistics up to the end of November 2017 have come in lower than expected. So far, wage growth over and above central agreements seems not to have been affected to any great extent by the high level of resource utilisation on the labour market. The second question, which was also important prior to the December meeting, concerns developments on the housing market. Housing prices in the country as a whole continued to fall in December, but at a slightly slower pace than in October and November. The assessment is that it is mostly the rapidly rising supply of newly built homes that has contributed to the price fall. The strong economic activity points to a continued healthy demand for housing. Housing construction will slow significantly during the forecast period and the decline is expected to happen slightly faster than in the forecast from December. The spillover effects of falling housing prices to other parts of the economy are still expected to be minor. Mr Hansson concluded by saying that a more thorough description of the housing market analysis is given in an article in the draft Monetary Policy Report.

§2. The economic situation and monetary policy

Deputy Governor Cecilia Skingsley:

I support the forecasts, assessments and draft monetary policy decision in the Monetary Policy Report. Inflation is close to target and economic activity is strengthening, justifying the Riksbank's forecast for initiating gradual rate rises during the second half of this year. At the same time, recently published price and wage data have been weaker than expected, justifying the downward revision of the inflation forecast for the quarters immediately ahead. The downward revision prior to today's meeting is of such a size that I have asked myself whether shifting the repo rate path towards postponed rate rises would be a better balanced monetary policy. I have decided nevertheless to support an unchanged repo rate path, given that the projected inflation rate, in my opinion, remains close enough to the target, seen over the whole forecast period.

Since last year, we have had inflation in line with the target. The aim of our work going forward is to keep inflation in line with the target. The Monetary Policy Report describes low inflationary pressures abroad relative to the strong economic activity. In addition, Swedish wage outcomes have come in lower than expected. In my statement, I would therefore like to describe my assessment of important factors as we move towards a projected phase of rate rises in monetary policy, which is expected to take place during the second half of this year. As we know, it has taken a long time and required more extensive monetary policy stimulus than expected to fulfil the inflation target and anchor inflation expectations. Monetary policy needs to remain expansionary and the projected rate rises need to occur gradually and, in my opinion, pay considerable attention to incoming data. It will then be important to assess the persistence of price pressures, so that, for example, a rapid appreciation of the krona or other unexpected event does not impair the role of the inflation target as a starting-point for price- and wage formation.

To assess the persistence of price pressures, the labour market and wages are key issues. This is described in the Monetary Policy Report, especially in the section on uncertainty and risks, and I would like to add some of my own comments. Wage growth is unexpectedly low in many advanced economies despite them being well into the recovery phase after the years of financial crises and low growth. In large economies such as the United States, Canada, Germany, Australia, as well as in Sweden, unemployment is close to or below levels at which wage growth, historically speaking, tends to pick up.

Musings on the functioning of the economy are nothing new. In the post-dotcom era of weak growth in the mid-2000s, the phenomenon of “jobless growth” was debated for a period, while we now can reflect on the phenomenon of falling unemployment without wage growth. This is occupying central banks and economists the world over and a large number of hypotheses are under discussion. To begin with, it is possible that the measures of spare capacity on the labour market are not identifying how difficult it is to find labour, and it is possible that employers in general can fill vacancies without needing to offer markedly higher wages.

But even if the increasingly strained resource situation on the labour market is described correctly, there are other possible explanations for why wage growth remains low. We are emerging from a number of years with a combination of low productivity, and low expectations of inflation and wages, which explains the low wage demands up to now. Technical innovations and international competition are forces that reduce the need for domestic labour. These forces, in combination with the long-term stagnation in the euro area after the financial crisis, also point to changed negotiation behaviour, with employees becoming more cautious with their demands. It is possible that the upheaval these forces cause at the workplace may also be making it difficult for individuals to assess their own risk of unemployment in relation to their colleagues, their sector, and the labour market as a whole. Low wage expectations are a global phenomenon and can contribute to a lower interest among those already employed in looking for a better-paid job. Thus, even in an economic boom, employers can hold back wage increases without the risk of losing valuable employees. These changes in wage formation may vary considerably in different economies. But they interact with each other due to the global market for goods and to a growing part of the service sector being traded globally. For example, the growth in self-employed persons and part-time positions, alongside changed wage composition, are factors which I believe to be less important in order to understand wage formation in Sweden, but which tend to crop up as explanations for low wage growth in other economies.

My assessment is, taken together, that there are cyclical forces that suggest wages will rise during the forecast period, but that the rate of increase may remain low despite the high level of resource utilisation. The question is then whether we now have a new normal of lower wage growth in relation to the labour market situation. My own personal view is that the Phillips curve, which indicates the correlation between wage growth and unemployment, is, in a permanent way, increasingly determined by global conditions. The Phillips curve has also flattened out, which implies that the effect of unemployment on wage growth is weaker. On the other hand, I am not sure that the flatter curve is permanent. When the effect on the economy from upheavals, such as technological advances or greater cross-border trade, has worn off, employees should be able to increase their pay again. It may, however, take time to come through similar shocks and during the transition, monetary policy's best contribution will be to facilitate the changeover via a high level of resource utilisation.

From a general economic perspective, the fact that there is scope to further reduce unemployment without causing a surge in wage growth that needs to be offset by tighter monetary policy is a welcome development. In this respect, I am pleased that we are not having to struggle with this kind of challenge, which was more common in the 1970s and 1980s.

To summarise, therefore, the present situation is satisfying although there is some concern for inflationary pressures in the period ahead, which calls for caution as regards when to initiate rate rises.

Deputy Governor Martin Flodén:

I support the proposal to leave the repo rate unchanged at –0.50 per cent and the draft Monetary Policy Report, including the forecast for the repo rate.

Economies abroad continue to develop well, in line with the forecast we presented in connection with the monetary policy meeting in December. New information has marginally surprised on the upside, however. In the United States, wages rose slightly more rapidly and in Germany, wage agreements in the manufacturing industry have been concluded on slightly higher levels than in recent years. There are now also signs of rising inflation expectations, long-term interest rates have increased quite significantly and the market's expectations of monetary policy abroad have shifted in a less expansionary direction.

In recent weeks, equity markets around the world have seen price falls and greater volatility. So far, most of the indications are that these price movements have not been caused by growing concerns or pessimism about the economic outlook. Instead, the combination of good growth and signs of increasing price and wage pressures seems to have generated uncertainty about how quickly interest rates will rise and how assets should then be priced. I am therefore not unduly worried that the turbulence we have so far seen on the equity markets will prevent continued good economic development.

The Swedish economy is also continuing to develop well. Employment continues to rise and resource utilisation is high. As in December, there is heightened uncertainty over developments on the housing market and construction, but activity in the economy is instead increasingly benefiting from improved economic activity abroad. The development of inflation still remains a source of worry, however, and despite inflation still being close to the target, I am more concerned about future inflation than at the monetary policy meeting in December. The most recent inflation outcome was indeed only marginally lower than expected, but the price groups that developed weakly are important in the assessment of underlying inflationary pressures. The most recent wage development indicators have also been surprisingly weak. Our inflation and wage forecasts for the next year or so have therefore been revised down quite significantly.

The key monetary policy question that I have been grappling with prior to today's monetary policy decision is how to tackle this continually weak inflationary pressure. How serious is it – in light of the fact that we are coming from a long period of inflation clearly undershooting the target – if inflation, as in our forecast, ends up some way below the inflation target in the year ahead? Which monetary policy is required for inflation to end up there and not fall even lower? Is there a meaningful monetary policy response that will lead to a more robust upturn in inflation?

My assessments of these questions is that the low inflation growth in our forecast is problematic but not alarming, that the forecast presupposes a monetary policy that continues to be very expansionary, and that a monetary policy response, had one been justified, would primarily have been to postpone the first rate rise. Allow me to elaborate on my reasoning behind these assessments.

Confidence in the inflation target and the Riksbank's monetary policy has strengthened over the last three years as the very expansionary monetary policy has had an impact in the form of higher inflation. This is reflected, for example, in different measures of inflation expectations having increased. An even more important indicator of strengthening confidence is, in my opinion, how monetary policy is being discussed in the media, among the social partners and in society more generally. A few years ago, the discussion was dominated by assertions such as the Riksbank not trying to attain the inflation target or it being more or less impossible to keep inflation at "such high levels" as 2 per cent due to globalisation and e-commerce. Over the last twelve months, the discussion has instead turned to the target now having been met and monetary policy not therefore needing to be as expansionary, and it is even said sometimes that inflation risks going too high unless the interest is immediately increased.

Confidence has also been strengthened by developments abroad. As in Sweden, foreign monetary policy has had an impact in the form of higher inflation and growth, leading to growing discussions about future inflation risks. This is also helping to hold up long-term inflation expectations in Sweden and thereby to limit the risks associated with our downwardly revised inflation forecast.

This stronger confidence in the inflation target and monetary policy is welcome, but my assessment is nevertheless that confidence has yet to be fully restored after the long period of low inflation. I suspect that confidence is still fragile and can quickly be lost if inflation once again falls significantly below the target, especially if the Riksbank, in such a situation, does not clearly show that we are doing what is required to ensure that inflation moves back to the target. And, in my assessment, what is required is a continued expansionary monetary policy that keeps resource utilisation at high levels and leads to continued expansionary financial conditions with an exchange rate that does not appreciate too quickly.

What "a continued expansionary monetary policy" means in more concrete terms is, of course, not completely self-evident, but for me it is mainly a question of the development of the repo rate and also how it relates to policy rates abroad. As I have said, I support the forecast for the repo rate in the draft Monetary Policy Report. The forecast can be interpreted as the repo rate probably being raised by 0.25 percentage points at one of the monetary policy meetings in July, September or October, and thereafter at approximately every third monetary policy meetings, i.e. twice a year.

Many factors will play a part in the assessment of when it will be appropriate to begin raising the repo rate. Among the most important factors I would like to mention are: (i) the inflation outcomes prior to these meetings and our analysis of what the outcomes mean for the development of inflation going forward, (ii) market expectations of the repo rate, how the expectations relate to our plans, and how they affect financial conditions; (iii) our and market expectations of monetary policy abroad; and (iv) developments on the Swedish housing market.

It goes without saying that the development of inflation is important. But it is worth pointing out that the inflation outcomes prior to the meetings in the summer and autumn will, according to our forecast, remain around the current level or perhaps slightly below. Surprisingly strong inflation in the spring could indeed be an argument for an early rate rise, but I do not envisage inflation necessarily having to rise before we raise the interest rate. More important is the assessment of underlying inflationary pressures in combination with an assessment of how much continued support the upturn in inflation will receive from strong economic activity in Sweden and abroad and how much the repo rate can deviate from international interest rates without the exchange rate appreciating too quickly in a situation where inflationary pressures remain weak.

Market expectations of the repo rate are now close to our own interest rate forecast. An initial rate rise in line with our forecast should therefore not lead to any major movements on the markets. But this assessment can be altered if expectations and pricing on the market change prior to the forthcoming monetary policy meetings, at which time we may need to reassess our monetary policy plans.

As regards monetary policy abroad, the euro area is of particular significance. Our forecast for the development of the repo rate, with approximately two rate rises per year in the coming years, does not significantly deviate from the market's priced expectations of the policy rate in the euro area. But we will obviously have to continue to consider how the repo rate relates to monetary policy abroad and assess how much deviation is justified by different economic conditions in Sweden and abroad. New signals concerning monetary policy abroad can therefore affect both the timing of our first rate rise and the pace at which the rate is raised thereafter.

I also mentioned developments on the housing market as an important factor for future interest rate decisions. Our forecast presupposes that housing prices will stabilise during the year and that construction will only fall moderately. I see this as the most likely scenario, but a greater slowdown and hence more significantly negative economic effects cannot be ruled out. In such a scenario, the development of inflation can be affected and the monetary policy plans may need to be changed.

Deputy Governor Henry Ohlsson:

To begin with, I would like to say that I do not support the proposal to hold the repo rate unchanged at –0.50 per cent. It is my opinion that the repo rate should be increased by 0.25 percentage points to –0.25 per cent. As a consequence of this, I also am of the opinion that the interest rate path should be brought forward so that it is consistent with my proposed repo rate increase.

The economic situation abroad is good. One expression of this is that global trade in goods is increasing. In recent months, the pace of trade growth has also picked up. This is of crucial importance for a small open economy like Sweden's. The latest measurements indicate annual rates of increase of around 4 per cent.

Annual growth abroad, KIX-weighted, is expected to amount to 2.7 per cent in 2018 according to the draft Monetary Policy Report. The forecast for 2019 has been revised up to 2.4 per cent compared with the Monetary Policy Report in December. Despite low inflationary pressures, aggregate KIX inflation is expected to be 2.1 per cent in 2018 and 2019. This is also an upward revision compared with the previous Monetary Policy Report.

The good global macroeconomic conditions mean that there are expectations abroad of a less expansionary monetary policy. The US central bank has increased its policy rate several times. According to the draft Monetary Policy Report, the KIX interest rate is expected to rise, albeit at a slow pace. It is worth noting, however, that upwards revisions have also been made here compared with the previous Monetary Policy Report. In this case, it concerns the forecast years 2019 and 2020. Expectations of increased policy rates have caused government bond yields around the world to start rising. This has become particularly clear at the beginning of 2018.

Let me now move on to Sweden. The annual rate of increase of the CPIF was 1.9 per cent in the most recent inflation reading in December. The corresponding reading for December 2016 was also 1.9 per cent. CPIF inflation has been around the inflation target for a long time. In the last nine months, CPIF inflation has been in the interval 1.8 – 2.4 per cent. According to the forecast in the draft Monetary Policy Report, inflation will be 1.8 – 2.0 per cent over the next three years. Target attainment is good.

The January reading of five-year inflation expectations among money market participants had a mean value of 2.0 per cent. Over the last 25 months, the mean value of five-year expectations has been 1.9 per cent or higher. Looking at the median value among respondents, five-year expectations have been 1.9 per cent or higher for 27 months.

The impression that inflation expectations are now back at the two-percent target is strengthened if we look at expectations two years ahead. In January, these were at 2.1 per cent. Looking back, two-year expectations have been 1.9 per cent or higher for the last 13 months.

Finally, one-year expectations in January were at 1.9 per cent or higher for the fifth month running. This is the first time this has happened since July-November 2011. It is difficult to argue that inflation expectations are not now well anchored.

According to the most recent labour force survey (LFS), unemployment was 6.0 per cent (not seasonally adjusted) in December. This is lower than the corresponding month one year earlier, when LFS unemployment was 6.5 per cent. Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. In January 2018, the share of openly unemployed insurance fund members was 2.7 per cent, according to figures published yesterday. It is approximately on the same level as the same month one year ago, when the proportion of unemployed fund members was also 2.6 per cent. But an important conclusion is that unemployment appears to have bottomed out. The unemployment figures from the autumn of 2017 also suggest this.

In my opinion, however, unemployment is still too high. But the question that should be asked is: Is it possible to reduce unemployment still further with general demand side policies? My assessment of the current situation is that the increasing demand for labour is causing labour supply to rise rather than unemployment to fall. This is also what the Labour Force Survey flow statistics show. There are important differences between reduced unemployment and increased labour supply. And it means that general demand side policies seem to be have reached the end of the road when it comes to bringing unemployment down.

Against the backdrop of this reasoning, I would now like to move on to my monetary policy considerations.

The global picture is therefore good and continuing to improve, with increasingly high growth and growing global trade. Inflationary pressures are, however, moderate, but inflation is rising around the world. Interest rates and interest-rate expectations are on the up.

In Sweden, resource utilisation is clearly above normal, and growth is high. Households and companies are more optimistic than normal. The labour market is booming. At the same time, however, unemployment seems to have bottomed out. This has important consequences for my view of monetary policy. The possibility that unemployment cannot be reduced any further using general demand side policies negates one of the arguments for the degree of expansiveness of current monetary policy.

The fact that unemployment has bottomed out also has implications for the distributional effects of monetary policy. The expansionary monetary policy has contributed to increased asset values, assets that we know are unevenly distributed. But this has been offset by the fact that the expansionary monetary policy has simultaneously helped to reduce unemployment. This offsetting effect has now been neutralised, thereby negating another of the arguments for the degree of expansiveness of current monetary policy.

Inflation has now been around the target of 2 per cent in outcomes and expectations for a long time. This is yet another argument indicating that it is now time to start normalising monetary policy. Occasional monthly variations of the odd tenth of a percentage point around the 2 per cent mark cannot determine monetary policy.

In conclusion, it is, therefore, my opinion that the repo rate should be increased by 0.25 percentage points to −0.25 per cent. As a consequence of this, I also am of the opinion that the interest rate path should be brought forward (but with the same gradient) so that it is consistent with my proposed repo rate increase.

Deputy Governor Per Jansson:

Since the December monetary policy meeting, one new outcome has been published for inflation and inflation expectations. The inflation outcome, which was for December, reported a CPIF inflation rate of just below 1.9 per cent. When adjusted for energy prices the outcome was just over 1.7 per cent. Both outcomes were almost a tenth of a percentage point lower than the forecast in the Monetary Policy Report in December.

With regard to the most recent survey of inflation expectations, Prospera's monthly questionnaire in January, the outcomes were unchanged for CPIF inflation and marginally rising for CPI inflation. Thus, the relatively large fall in expectations noted in connection with the December meeting has been stopped and partly reversed. This is of course positive, although the survey only concerned money market participants. It is now important that the favourable development tendency is also reflected in Prospera's next quarterly questionnaire, which will cover responses from a larger number of participants. The way that labour market organisations expect inflation to develop in coming years is of particular significance. If their expectations remain close to the inflation target, there should be good conditions for wage increases to gradually pick up.

The conclusion I draw from the developments in inflation and inflation expectations is that the current picture for inflation remains fairly bright. This is of course good, but it is also important, as I have pointed out on several previous occasions, that this continues to be the case. And on this point, unfortunately, there has recently been increasing cause for concern. This leads me into discussing the forecast and risk outlook for inflation.

The draft Monetary Policy Report now proposes fairly extensive downward revisions to the forecasts for CPIF inflation and CPIF inflation excluding energy prices, particularly from summer this year to summer next year. The downward adjustments to the forecasts are undertaken against the background of more underlying inflationary pressures having recently begun to show some signs of weakness. And there is reason to believe that these signs of weakness will continue to impact developments in inflation for some time.

As I just mentioned, the most recent inflation outcome was around 0.1 percentage points below the assessment in the most recent Monetary Policy Report. The forecasting error is fairly small and of course does not as such give any reason for major concern. But in a situation where the idea is that domestic economic activity shall have a greater impact on prices, it is nevertheless worrying that it is an unusually weak development in service prices that lies behind the negative inflation surprise. When the December figures are included, the rate of increase in services prices has now declined five months in a row, landing at 2.3 per cent in December. With reasonable assumptions for other prices in the CPI basket, this is a rate of increase that is most probably not sufficient to manage to stabilise inflation close to the target going forward.

Unfortunately, there are also indications that wages are continuing to increase more slowly than expected. New estimates of short-term wages based on preliminary outcomes now suggest that the definitive outcomes for 2017 will be lower than we have earlier believed. The forecast in the draft Monetary Policy Report for wage developments in 2018-2019 has also been adjusted down slightly. And it is pointed out that the supply of labour could increase faster than is assumed in the current forecast proposal, which could have a further dampening effect on wage growth in coming years.

The relatively large write-down in the inflation forecast and the risk that developments will be even worse are of course worrying. To be able to stabilise inflation around the target, one therefore must not be in too much of a hurry to normalise monetary policy. On an overall level, the normalisation needs to be timed so that the inflation effects from the strong economic activity in Sweden and the increasing price pressures from abroad dominate over the effects of the stronger krona. In the shorter perspective, inflation is also expected to be pushed down by some temporary factors, the effects of which appear to be particularly strong during the summer months. There is throughout considerable uncertainty over the development of inflation, which is well illustrated by the fact that several other forecasters believe that the dampening effects on inflation as of the summer will be much greater than the Riksbank is assuming.

In this environment it is particularly important that monetary policy is designed so that inflation expectations work for rather than against us. As we have had an inflation rate that is too low for many years, expectations may currently play a greater role than normal for the evolution of inflation, particularly in the sense that expectations may show an unusually large sensitivity to negative inflation surprises. A credible inflation target that finds its way into all parts of price-setting and wage-formation makes it much easier when it comes to managing the inflation target going forward. The experiences from the 1990s are a clear example here, when it was possible to make the inflation target credible, despite the fact that inflation had been very high during the 1970s and 1980s, and even the staff at the Riksbank were doubtful as to whether it would work.

Given this background, my impression is still that the forecast for the repo rate in the draft Monetary Policy Report means that the repo-rate increases begin too soon. But just as in December, I am choosing not to enter a reservation against the repo-rate path. The most important reason for this is that our interpretation of the repo-rate forecast is now more flexible and opens up for postponing the increases at the coming meetings. The plan is now said to be to begin raising the repo rate “during the second half” of this year, compared with the wording, in the middle of 2018, used in the December Monetary Policy Report. We also express clearly that “the uncertainty surrounding the development of inflation means that monetary policy needs to proceed cautiously” and that “the downside risks deserve particularly close attention in the current situation”.[1]

I thus support the monetary policy in the draft Monetary Policy Report. And I also support the forecasts proposed there, although I do have a slightly different view of the risk outlook and what significance it should be given in monetary policy. I intend to devote the rest of my contribution

[1] The quotations in the paragraph are taken from the Swedish draft Monetary Policy Report February 2018, pages 5, 10 and 13.

to discussing in some more detail how I currently view the timing of the first repo-rate increase and describing some of my thoughts on an appropriate size for the initial increases.

Let me begin by looking ahead to the monetary policy meeting in July. Here, in my view, the probability is very low that the conditions will be right to raise the repo rate. We will then only have outcomes for inflation up to and including May. And the risk outlook for inflation during the following months is clearly on the downside, in any case if consideration is given to the assessment made by many other forecasters. If the repo rate is then raised and inflation subsequently becomes low, there is a risk, even if this were largely due to temporary factors, that it will be perceived as “a new major failure” for the Riksbank's monetary policy, which could have negative consequences for expectations and confidence. In addition, at that point in time, I do not think it is likely that the ECB will have communicated much new information on how it intends to manage its asset purchases after September and what this will in turn mean for the bank's interest-rate policy.

Looking towards our next monetary policy meeting in September, the conditions for raising the repo rate do not look much better. At that juncture, we will have access to outcomes for inflation up to and including July, so we will still not have the full answer regarding the critical summer months. Of importance to note here is that it is not just the answer regarding the size of the downward pressure on inflation that we would like to have, but also regarding whether inflation thereafter actually picks up again. As the ECB has its monetary policy meeting around one week after the Riksbank, there is also a considerable risk that, at our meeting in September, there will still be a lack of new information on monetary policy in the euro area.

The next possible occasion to raise the repo rate will be the monetary policy meeting on 23 October. At that meeting, inflation outcomes up to and including September will have been published. There will thus still be some questions remaining with regard to inflation developments. But we will at least have put the critical summer months behind us. With regard to new information from the ECB, too, the conditions are much better in October. As the current programme for asset purchases runs out in September, a new stance on whether to continue or to cease purchases must have been taken and communicated by then. Hopefully the ECB will also, in this context, have provided some clarification as to how it views its future interest-rate policy.

To summarise, the monetary policy meeting in October appears to be the first meeting with fairly reasonable conditions for implementing an initial repo-rate increase. Of course, it is at present not possible to rule out the possibility of raising the repo rate before then. But right now the probability of doing so seems very slight and, at least as I see it, it seems to require a number of positive inflation surprises in the coming months to change this assessment. In contrast, that it might be necessary to wait until December, or even until sometime next year, is a scenario that I personally believe is more likely. Even with the Riksbank's relatively optimistic inflation forecast, CPIF inflation is still expected to be below 1.7 per cent in September and underlying inflationary pressures are expected to still be fairly shaky.

I shall conclude with some thoughts on an appropriate size for the initial repo-rate increases. The repo rate has now been below a normal level for a long period of time, perhaps almost ten years. During this time, a new generation has emerged that has become accustomed to interest rates always being very low. Given this, it may be wise to start by increasing the repo rate in very small steps. If excessively low expectations exist and are corrected in connection with an increasing interest rate, there may be adjustment problems. Although data do not suggest that such misalignments of expectations will prevail, it is always best to be cautious. And such adjustment problems can be alleviated if the interest rate is raised very cautiously in the beginning. It may also be a way of testing households' sensitivity to interest rates, which is considerable given that many loans have short interest-rate fixation periods. In addition, very cautious interest-rate increases to start with can help to avoid an overly large and rapid appreciation of the krona.

Having said this, one cannot of course implement the entire normalisation of monetary policy with unusually small interest-rate changes on every occasion. It would then simply take too long to bring the interest rate up. This question, like the question of the timing of the first repo-rate increase, needs to be discussed further at our monetary policy meetings in the coming period.

First Deputy Governor Kerstin af Jochnick:

I support the forecasts and assessments in the draft Monetary Policy Report, and I also support the proposal to hold the repo rate unchanged at −0.50 per cent and to leave the repo-rate path unchanged.

Our forecast for the development of inflation in 2018 and 2019 contains minor adjustments in relation to the December Monetary Policy Report. However, there are some question marks that could affect the development of inflation and our assessment of the repo-rate path further ahead. I will come back to this.

I shall begin with international developments, as they are of considerable significance for developments in Sweden. Global trade in goods is still developing very strongly. Indicators of confidence among households and companies also point to continued optimism and good growth.

The positive development is continuing in the United States, and growth during the forecast period will be further strengthened by the tax reform. The euro area, which is the economic region of greatest significance for Sweden, is developing better and better. And as I said at the monetary policy meeting in December, it may be the case that we are underestimating the strength of the growth in the euro area. A number of indicators of developments in the euro area point to continued strong developments.

Despite the positive growth outlook, inflation is still low in most countries. This also means that the central banks' normalisation of monetary policy abroad is proceeding very slowly. In many countries, wage increases are lower than one might have expected in this economic climate with high resource utilisation, low unemployment and shortages of staff in several branches. With regard to the euro area, inflation developments are also pushed down by the euro strengthening in relation to the dollar.

I would also like to comment on the global stock market unease in recent weeks. The volatility index (VIX) rose at the beginning of February to levels we have not seen since 2009. It is as yet too early to fully understand the background to and the effects of the increased stock market unease, but the trigger factor appears to have been the unexpectedly strong wage statistics in the United States, which made market participants revise up their expectations of inflation and coming policy rate increases from the Federal Reserve.

One can conclude that the major fluctuations on the stock markets are a certain sign of nervousness on the market, following a period of sharply rising share prices. The fluctuations are also coming at a time when the Federal Reserve has started the normalisation of its monetary policy and inflation in the United States is approaching the target level. A downward adjustment of stock prices is therefore not entirely unexpected.

Given the good economic activity in both the US economy and the global economy, my assessment is that what has happened so far on the stock market will not have any significant effects on the prospects for growth and inflation abroad. Having said this – if we were to have a protracted period of stock market unease it could ultimately have a negative effect on confidence among households and companies and in the worst case subdue global economic activity and inflation.

In Sweden, the real economy is developing in line with our earlier forecasts. However, housing investment has been revised down somewhat and thus also GDP growth. In this situation, I do not predict any drama in the development of housing investment and the effects on GDP growth.

If there were increasing concern on the housing market and a larger fall in prices than we are currently anticipating, the forecasts for housing investment may also need to be adjusted downwards. But in such a situation we would probably be faced with other – and probably greater – problems, linked to confidence in the Swedish housing market. I will return to this later.

Despite the good economic situation, inflation in Sweden is not fully developing in the way that we had forecast in the previous Monetary Policy Reports. Service prices have been lower than our forecasts for two months in a row. The differences between forecast and outcome are not very large, but if service prices continue to develop weaker than we have previously assessed, this will affect the possibility to stabilise inflation around 2 per cent.

Nor have wages in Sweden risen at the pace we had forecast. The fact that wages are not rising more when we have an economic upturn and an increasing shortage of staff in several sectors has been a surprise both for us and other forecasters. The picture appears to be the same in many other countries.

Perhaps it is the case that after a long period with low inflation, it takes longer to get back to a more normal wage development in line with historical patterns. But there are a number of other factors that may also have subdued wage developments.

We have pointed out in previous reports that productivity development has been weak; that the percentage of those joining trade unions is lower; that fixed-term employment contracts have increased; and that the supply of labour has increased. These factors contribute to subduing developments in wages. [2]

A further factor that we have highlighted is the international competitiveness aspect. Wage developments in the euro area and above all in Germany play an important role for wages in Swedish industry. As these wages in turn are to a large extent the starting point for wages in other sectors in Sweden, it is particularly important to follow wage developments in Germany and the agreements that the IG-Metall union has recently signed with employers. The agreement appears to confirm our picture from the most recent monetary policy reports: That wages in Germany are being renegotiated in a stronger economic situation than before indicates that wage growth will rise.

The structural problems on the housing market in Sweden are still a source of concern and comprise a major risk for the Swedish economy. Lending to households is continuing to grow at an annual rate of around 7 per cent. And the debt ratio is rising, albeit at a somewhat slower pace in the coming years, according to our forecast.

All of the questions we have discussed earlier still remain with regard to risks linked to the high indebtedness. Tax rules that contribute to a smoothly functioning housing market and a macroprudential policy that supports sound development would contribute to reducing the vulnerability of the Swedish economy and create better conditions for economic developments in Sweden. Finansinspektionen's stricter amortisation requirements are a welcome step in the right direction, but a lot of work remains to be done, and in several different policy areas.

To summarise, I advocate the following: Holding the repo rate unchanged at −0.50 per cent and leaving the repo-rate path unchanged.

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[2] See, for instance, the article "Strong economic activity but subdued wage increases" in the July 2017 Monetary Policy Report.

The expansionary monetary policy will continue to provide support to the Swedish economy and safeguard the role of the inflation target. There are many indications that the strong real economic developments will lead to higher inflation in Sweden and abroad.

On the other hand, it is not possible to rule out the possibility of the correlation between resource utilisation and inflation having weakened more lastingly for various reasons, as I mentioned earlier. As we write in the draft Monetary Policy Report, the downside risks for inflation prospects at present deserve special attention. The coming months will be particularly interesting with regard to the development of service prices and wages.

In light of this, the above-mentioned uncertainty factors could also be seen as arguments for postponing rate rises slightly. If conditions were to change, the Executive Board is prepared to adjust monetary policy.

Governor Stefan Ingves:

I share the view of economic developments in Sweden and abroad that is described in the draft Monetary Policy Report, and I support the proposal for a monetary policy decision that involved holding the repo rate at its current level of −0.50 per cent. Monetary policy also includes the reinvestments of redemptions and coupon payments in the government bond portfolio decided on at the December meeting.

Economic developments abroad are still strong and in line with the assessments made in December. What we are seeing now is, I believe, a fairly unusual synchronised economic upturn in the major economies. Despite the strong growth, global inflationary pressures are moderate. The assessments of the economic outlook and inflation prospects in Sweden are roughly the same as in December, which in my opinion also means that it is appropriate to hold monetary policy unchanged.

It is now almost exactly three years since the Riksbank began the purchases of government bonds, at the same time as the repo rate was cut below zero for the first time. This policy has had the intended effect in the form of an upward trend in CPIF inflation. We are now more or less where we want to be. But this does not mean our task is finished. Now we need to ensure that inflation continues to develop in line with the inflation target of 2 per cent. But the recent outcome for inflation was lower than our forecast. This, and the developments in service prices and wages, for instance, mean that we need to remain vigilant and closely monitor the different components and determinants of inflation.

The good economic growth abroad and in Sweden, with resource utilisation above normal and rising inflation, has led to the time for the Riksbank to reduce its monetary policy stimulus drawing closer. In the United States, they are already in a phase of less expansionary monetary policy, while the ECB has yet to begin normalising its monetary policy. For the formulation of monetary policy in a small, open economy, the monetary policy conducted by the large currency areas and the relations between them are one of the most important determinants.

In this context, the development of the Swedish exchange rate is important. According to the assessment in the Monetary Policy Report, CPIF inflation is expected to fall somewhat in 2018 and then in 2019 to stabilise around 2 per cent, at the same time as the Swedish krona is expected to appreciate. But the development of the exchange rate is a risk factor, as an overly rapid appreciation could threaten this development for inflation.

I consider it important at present to be vigilant and cautious in our monetary policy. We need to closely follow developments in Swedish inflation, and also what other central banks are doing, how the normalisation is occurring and at what pace. I see only minor risks in being cautious. If inflation were to be higher than we have forecast, it would not be difficult to adjust our monetary policy. However, the low interest rates entail a build-up of risk that requires monitoring, and without wishing to repeat myself, I support what Kerstin af Jochnick recently said about the Swedish housing market.

To summarise, the monetary policy considerations stated in the report on pages 8 and 9 capture my view of present monetary policy. This also includes a preparedness to push the repo-rate path forward if this should be necessary to meet the inflation target in the long run.

Finally, let me note that this is the first time the minutes of the monetary policy meeting have been transcribed in a first-person form and with a shorter time to publication. I hope that this is a reform that will be successful.

§3. Discussion

Deputy Governor Martin Flodén:

I have two comments and one question with regard to Henry Ohlsson's contribution to the debate.

I said in my first contribution that I suspect that confidence in the inflation target and monetary policy is fragile, while Henry argued that inflation expectations are now well anchored. Inflation expectations now having been close to two per cent for some time has coincided with a period when inflation has risen and for some time now been close to the target. It is difficult to see whether the boat is well anchored until the wind blows. And it is difficult to know whether inflation expectations are well anchored when inflation is close to the target. I suspect, as I said, that expectations would now, after the long period of too low inflation, be less robust than usual if inflation were to once again fall clearly below the target.

My second comment concerns how the high level of resource utilisation affects employment and unemployment. We can still see good employment growth and moreover increasingly clear signs, albeit with inadequate data, that groups which are normally furthest from the labour market are finding it increasingly easy to get jobs and that unemployment in these groups is falling. There are a number of indications that a high resource utilisation over a slightly longer period is necessary to push down not only unemployment but also equilibrium unemployment, via persistence effects.

Finally, I also had a question about the forecast. Henry Ohlsson said that target attainment is good. But the forecast in the draft Monetary Policy Report is based on the repo-rate path contained therein. I did not understand how Henry views the forecasts, particularly the inflation forecast, contingent on his proposed monetary policy.

Deputy Governor Henry Ohlsson:

If we start with inflation expectations, there is no other way to assess whether inflation expectations are firmly anchored than to look backwards. How else would one do? We know that five-year expectations have been on target for more than two years. During the first of these years, inflation expectations were on target despite the actual inflation outcomes being much lower. For me, this emphasises the fact that inflation expectations have been firmly anchored for a longer period of time.

With regard to developments in employment, I agree that they have been good, but for me the implications for redistribution are important. As I said during my contribution, the implications differ widely depending on whether it owes to increased labour supply or to lower unemployment. It is of course very pleasing that unemployment is declining for vulnerable groups on the labour market, but in the current labour market this has more to do with targeted labour market policy than general demand policies. My assessment is that labour market policy will play a more important role going forward.

Finally, with regard to target attainment, this also concerns looking back at the actual outcomes. As I said in my contribution here, CPIF inflation has been within the interval 1.8–2.4 per cent for the past nine months. With regard to the inflation forecasts, it is of course clear from my monetary policy proposal that I do not support all parts of the draft Monetary Policy Report.

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

The Executive Board decided

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

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

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

§5. Other decisions

The Executive Board decided

• to publish the Monetary Policy Report and decisions under paragraph 4 with the motivation and wording contained in a press release at 9.30 a.m. on Thursday 14 February 2018, and

• to publish the minutes from today's meeting at 9.30 a.m. on Friday, 23 February 2018.

This paragraph was verified immediately.

Minutes taken by

Maria Kindborg

Verified:

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

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