Monetary policy minutes

July 2019

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

Summary

At the Monetary Policy Meeting on 2 July 2019, the Executive Board of the Riksbank decided to leave the repo rate unchanged at –0.25 per cent. The forecast for the repo rate is also unchanged and indicates that it will be increased again towards the end of the year or at the beginning of next year.

The board members supported the picture of the economic outlook and inflation prospects described in the draft Monetary Policy Report. Economic activity in Sweden remains strong and inflation is close to the target of 2 per cent. They noted that economic development both in Sweden and abroad has been largely in line with the Riksbank's forecasts and that new information since the monetary policy meeting in April has not led to any major revisions of the forecasts overall. This argues for not changing monetary policy either at this meeting.

At the same time, the board members emphasised that uncertainty in the international economy has increased, for example due to the escalated trade conflict between the United States and China. It was noted that participants on the financial markets seem to be expecting significantly worse economic development in the period ahead and hence further monetary policy stimuli. In several of the major economies, central banks have also signalled that monetary policy may become more expansionary, albeit not to the same extent as market pricing indicates. International risks are difficult to quantify in a forecast, but if they materialise, prospects may also deteriorate for the Swedish economy. It is therefore important that monetary policy proceeds cautiously.

The board members also noted that inflation in the months ahead will fall markedly as a result of lower energy prices. In this context, it was pointed out that if this were to significantly dampen inflation expectations, the ability for monetary policy to keep inflation close to 2 per cent would worsen. Several board members also pointed to the importance of underlying inflation continuing to rise.

Several of the board members discussed the development of the Swedish krona. Some referred to an article in the draft Monetary Policy Report which discusses the krona's development in the longer term and draws the conclusion that the krona should gradually appreciate going forward, but uncertainty is considerable regarding by how much and how quickly this will happen. Some also emphasised that large and unexpected fluctuations in the exchange rate make it more difficult to stabilise inflation around the target.

A few board members highlighted the fact that developments on the housing market and the risks associated with the high level of household indebtedness constitute a vulnerability for the Swedish economy.

The intended changes to the operational framework for the implementation of monetary policy were also mentioned. The changes are of a technical nature and are not aimed at altering the direction of monetary policy but at making implementation of monetary policy as efficient as possible.

All board members supported the decision to leave the repo rate and the forecast for the repo rate unchanged to provide continued support to inflation. But there were some differences of opinion as to exactly when it might be appropriate to raise the rate next time.

MINUTES OF MONETARY POLICY MEETING
Executive Board, No. 3

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DATE: 2 July 2019

TIME: 09.00

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

Charlotta Edler
Heidi Elmér
Robert Emanuelsson
Mattias Erlandsson
Eric Frieberg
Jesper Hansson
Jens Iversen
Maria Kindborg
Ann-Leena Mikiver
Carl-Fredrik Pettersson (§ 1-3A)
Henrik Siverbo
Maria Sjödin
Ulf Söderström
Emelie Theobald
Jens Vahlquist (§1-3A)
Ingrid Wallin Johansson (§ 1-3A)
Anders Vredin

It was noted that Emelie Theobald and Henrik Siverbo would prepare the draft minutes of the monetary policy meeting.

§3a. Economic developments

Market developments since the last monetary policy meeting

Carl-Fredrik Pettersson from the Markets Department began by presenting the latest developments on the financial markets. Since the monetary policy meeting in April, long-term government bond yields have fallen by between 25 and 30 basis points in Sweden and Germany while they have fallen by around 50 basis points in the United States. At the same time, communication from several central banks in major economies has indicated that more expansionary monetary policy may be required in the period ahead. The main reason for this development is the uncertainty surrounding future developments due to the ongoing trade conflict between the United States and China. Alongside the risk of an escalation in trade conflicts, it may be the case that the tariffs already introduced have impaired global value chains. Economic indicators, such as the Purchasing Managers' Index, have fallen back in many countries, affecting financial markets. Falling inflation expectations and lower-than-expected inflation outcomes have also been noted by market participants and central banks. In the United States, weaker statistics for overall economic activity are being recorded and there are signs that the contribution to growth from the fiscal policy stimulation is starting to wane. Substantial downturns were noted on equity markets in May but a recovery in June means that equity prices are now on approximately the same level as they were at the time of the monetary policy meeting in April.

There have also been substantial movements in the oil price since April. A gloomier view of global demand and rising US oil stocks have contributed to a softening of the oil price. At the same time, there are several supply factors having the opposite effect, including the expected extension of output restrictions by the OPEC countries and geopolitical unease in the Middle East.

The main focus has recently been directed towards the world's central banks. Norges Bank has recently raised the policy rate and further increases are expected against the backdrop of a strong domestic economy which is not so exposed to ongoing trade conflicts. For most other central banks, development is going in the opposite direction. Both the European Central Bank (ECB) and the US Federal Reserve have communicated that more monetary policy stimulation may be needed to counter weaker economic development. Market pricing has shifted downwards and substantial rate cuts are now expected in the United States. Regarding the ECB, there are expectations of a rate cut and a restart of asset-buying programmes. Similarly for Sweden, expectations of further monetary policy stimulation have increased. Pricing on the financial markets now indicates a higher probability of a rate cut than of a rate rise while bank economists in general expect a postponement of the repo rate increases. At today's monetary policy meeting, the repo rate is expected to be left unchanged.

The exchange rate for the krona has strengthened since mid-May and is now back at approximately the same level as at the monetary policy meeting in April. It is above all a weaker dollar and the inflation outcome in May that have contributed to the stronger development of the Swedish krona.

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 a majority of the Executive Board. The monetary policy drafting process has included discussions with the Executive Board regarding the forecasts and the monetary policy assumptions at meetings on 11 and 18 June. The draft monetary policy report was tabled at a meeting with the Executive Board on 25 June. During the drafting process, particular weight has been given to the uncertainty surrounding the world economy, analysis of the global decline in interest rates in recent times and analysis of the krona's long-term development.

There is still concern over the global economy. Despite stronger-than-expected GDP outcomes in many countries in the first quarter, confidence indicators point to an increased risk that economic activity going forward may slow down more rapidly than expected. The escalated trade conflict between the United States and China, the process for the United Kingdom's withdrawal from the EU and increased geopolitical unease are contributory factors. Concern over the global economy has contributed to further falls in bond yields, although lower inflation expectations are also an important explanation.

The krona has depreciated to an unexpected degree during 2019. An article in the draft Monetary Policy Report presents new analyses of the krona's long-term development. The article highlights the development for several different measures of relative price levels and costs. The overall conclusion is that the krona is unexpectedly weak and that a certain appreciation is to be expected, but that there is considerable uncertainty as to both when and by how much the krona will strengthen.

Growth in both the United States and the euro area was somewhat stronger than expected in the first quarter of this year, but is expected to soften to an approximately normal level thereafter. Confidence indicators in Sweden and abroad have fallen since last autumn to levels close to the historical average, which indicates normal growth in the period ahead. The forecast for KIX-weighted GDP growth in 2020–2021 has been revised down by 0.1 percentage points, to 2.0 per cent, as a result of introduced trade restrictions and concern over new or escalated trade barriers that may dampen economic activity.

Inflation abroad also looks like it will be slightly lower. In the euro area, underlying inflation remains low and inflation expectations have fallen according to market-based measures. The poorer growth prospects, increased concern over trade conflicts and lower inflation expectations have contributed to a relatively substantial fall in the market pricing of future policy rates. Several central banks have communicated that monetary policy may be made more expansionary, but probably not to the extent indicated by market pricing.

In Sweden, unemployment has fallen six years in a row, but now looks like it has bottomed out and has been around 6.3 per cent since the beginning of 2018. The employment rate also looks like it is levelling off at a high level. Swedish GDP growth surprised on the upside in the first quarter of this year, with 2.4 per cent compared with the preceding quarter, calculated in annualised terms. The strong growth was primarily driven by increased service exports, while development in domestic demand was rather weak. The GDP forecast has been revised down slightly for the coming quarters. The strong start to 2019 still means, however, that the whole-year forecast for this year has been adjusted marginally upwards to 1.8 per cent, but next year, GDP is expected to increase somewhat more slowly compared with the forecast in April. The relatively decent growth rate is in line with confidence indicators for the business sector, which are still at approximately normal levels.

In May, inflation was 2.1 per cent, exactly the same as the forecast in the Monetary Policy Report in April. Energy prices, both fuel and electricity, have fallen dramatically in June, dragging down inflation in the year to come. The forecast is based on energy prices developing in line with forward pricing, which is relatively unchanged in the period ahead. This means that the lower energy prices will only lead to a temporary effect on inflation. CPIF inflation is expected to bottom out at 1.2 per cent in September. The forecast for CPIF inflation excluding energy has only been marginally revised and it is expected to rise from 1.7 per cent in May to 2 per cent during 2020.

The exchange rate weakened to begin with after the monetary policy meeting in April but has recently strengthened again. Overall, the krona is now at approximately the same level as before the monetary policy meeting in April, but is weaker than the forecast from April. The exchange rate is expected to be unchanged in the short term, but as before, a certain appreciation is expected to occur in the longer term. This is based on inflation and resource utilisation in Sweden being slightly higher than in other countries and on interest rates therefore increasing slightly more in Sweden.

The forecasts now presented are based on the monetary policy that is expected to gain a majority at today’s monetary policy meeting. This involves the repo rate being left unchanged at –0.25 per cent. The repo rate path is unchanged compared with April and it indicates that the repo rate will remain at –0.25 per cent until the end of the year or the beginning of 2020. More precisely, the rate path means that an initial rate rise may occur in October, December or February. After that, the repo rate will be raised by just under 0.5 percentage points a year. The forecast for economic activity and inflation is also influenced by the size of the balance sheet. According to the decision at the monetary policy meeting in April, the Riksbank will buy government bonds for a total of SEK 45 billion expressed as a nominal amount during the period July 2019 – December 2020. This keeps the Riksbank's bond holdings and the liquidity surplus in the banking system close to the average level since the beginning of 2018.

§3b. The economic situation and monetary policy

Deputy Governor Per Jansson:

Since the monetary policy meeting in April, two new outcomes for inflation and inflation expectations respectively have been published. The inflation outcomes are for April and May. Following major disappointments during the first three months of the year, when both CPIF inflation and CPIF inflation excluding energy prices were much lower than expected, the outcomes for April and May were very close to our forecasts. It is particularly pleasing that CPIF inflation excluding energy prices, which can be regarded as a measure of longer-term trend, or underlying, inflation, has increased quite substantially, from 1.4 per cent in January to 1.7 per cent in May. The May result is the highest figure for CPIF inflation excluding energy prices for almost one and a half years. It is very significant that the rate of increase for this measure of inflation is increasing now, as energy prices will soon be contributing much less to price developments. Including energy prices, inflation was just over 2 per cent in both April and May.

Developments in the Riksbank's other measures of underlying inflation are also on the positive side. After varying within a fairly narrow interval of 1.4–1.7 per cent between January 2018 and January 2019, the median value of the measures of underlying inflation has shown an upward trend in recent months, amounting to 2 per cent in May. The two measures that have been shown in an empirical evaluation to be best at predicting future CPIF inflation, UND24 and CPIFPC, were at 2 and 1.9 per cent respectively in May.[1]

The new outcomes for inflation expectations, as measured in Prospera's monthly and quarterly surveys, consist of the monthly survey for May, which only applies to money market participants, and the larger quarterly survey for June, which also includes the inflation expectations of labour market organisations, among others. The overall picture is that expectations are falling slightly but that they are still reasonably close to the inflation target. Labour market organisations' inflation expectations, which I assess to be particularly important for the Riksbank to monitor, are in the interval 1.8–2.1 per cent, with a tendency to be somewhat lower with regard to employers' organisations.[2] However, the differences should not be exaggerated and five years ahead both employers' and employees' organisations are expecting a rate of inflation at or just over

[1] See the article "Why measures of core inflation?" in Monetary Policy Report, October 2018.

[2] I am focusing here on the expectations regarding CPI inflation rather than CPIF inflation, as the response rate for CPIF inflation is very low.

2 per cent, which indicates that they have confidence in the Riksbank's ability to attain the inflation target. It is of course very important that this confidence is maintained in the future, so that all can agree that an inflation rate of 2 per cent is the best basis for the coming wage bargaining rounds.

The conclusion I draw from the development of inflation and inflation expectations is that the current inflation picture is relatively bright, in line with what we were expecting in the April Monetary Policy Report. Given this, the changes to the inflation forecast proposed in the draft Monetary Policy Report are also fairly minor. The largest revision concerns the contribution to inflation from energy prices, which is now expected to be lower. It is therefore proposed to revise down the forecast for CPIF inflation by 0.2–0.4 percentage points over the next twelve months. This means that the coming temporary decline in CPIF inflation, which has been shaping our forecasts for some time, is now expected to be slightly greater, bottoming out in September at 1.2 per cent instead of at 1.5 per cent, as assumed in the April Report. The assumption that the decline will indeed be temporary is of great significance and supported by the rising rate of increase in CPIF inflation excluding energy prices in recent months. I support both the macro forecast and the monetary policy in the draft Monetary Policy Report.

The central theme in the draft Monetary Policy Report is international developments and the risks they entail. I consider it reasonable in this situation to have a strong focus on what is happening outside of Sweden's borders, even if there now appears to be a certain silver lining in the trade conflict cloud between the United States and China, following the meeting between the two countries' leaders in connection with the G20 summit this weekend. But it is important to remember that there are also risks for Swedish inflation in scenarios where international developments are largely as we expect in our main forecast. For instance, wage growth in Sweden continues to be moderate. There are many factors indicating that wages should rise at a faster pace going forward, including a strong labour market, inflation and inflation expectations close to 2 per cent, and a higher growth rate in productivity. If wage growth does not increase in the coming years, roughly as we are assuming in the draft Report, it will be very difficult, and perhaps even impossible, to keep inflation close to 2 per cent.

When it comes to the current international risks, we have emphasised on several previous occasions that these are very difficult to quantify in a forecast. They are therefore largely outside of the main scenario in the draft Monetary Policy Report. While this certainly continues to be the case, there is now nevertheless a fairly clear tendency for some of these risks to gradually migrate into the main scenario. This applies in particular to interest rates, which have fallen significantly in many countries. And our forecasts in the main scenario must of course be conditional on what is happening to actual interest rates. On top of this, we have now slightly downgraded the prospects for international growth, largely due to the escalating trade conflict.

It is important in this context to point out that the lower interest rates are partly a consequence of expectations in financial markets of a more expansionary monetary policy. That it is now in fact reasonable to expect that monetary policy will become more expansionary has recently been corroborated by communication from both the ECB and the Federal Reserve. The relatively large and rapid change of direction undertaken by these central banks has been remarkable and surprising, at least to me.

The problems and risks relating to inflationary pressures in Sweden and developments abroad mean that one might fear that the probability currently embedded in our repo-rate path of a rate increase as early as October or December is too high. This applies in particular if both the ECB and the Federal Reserve choose to increase their monetary policy stimulus soon. In that case, going in the opposite direction will of course be rather risky.

The reason I am today nevertheless supporting the monetary policy described in the draft Monetary Policy Report is the major uncertainty surrounding all of these significant aspects at present, with regard to both scope and timing. Given this, I consider that it is too early right now to revise our monetary policy plan. I prefer instead to await further information, in the hope that the fairly dense fog now prevailing will disperse somewhat. In addition to a continued discussion of the conduct of monetary policy in the short term, there may also be a need to return fairly soon to the question of what comprises an appropriate repo rate in the longer run, when cyclical economic activity is more normal. As is pointed out in the draft Monetary Policy Report, this question has now gained further relevance in light of the large decline in bond yields in several countries.

First Deputy Governor Kerstin af Jochnick:

I support the assessments and forecasts in the draft Monetary Policy Report, and I also support the proposal to hold the repo rate unchanged at –0.25 per cent and to leave the repo-rate path unchanged. I also think that bond purchases should continue in accordance with the decision in April.

Since the monetary policy meeting in April, developments abroad have largely been in line with our forecasts. In addition, in KIX-weighted terms, the forecast for GDP growth has only been marginally revised. In my opinion, however, the uncertainty about the strength of developments abroad is greater now than in April. Increased unease about poorer global economic development is reflected, for example, in pricing on financial markets, something which Jesper Hansson alluded to previously.

The trade conflict between the United States and China has probably contributed to the increased uncertainty. Chinese exports to the United States have decreased significantly, which is clearly illustrated in Figure 4:3 in the draft Monetary Policy Report. Although China has been able to counteract weaker development in exports with expansionary fiscal and monetary policy, there is a risk of weaker growth in China than in our forecast. Such a development could spill over to global trade and ultimately have a negative effect on the demand for Swedish goods and services. At last weekend’s G20 meeting, hopes were raised that negotiations on a trade agreement between China and the United States would continue. However, it is too early to assess what this means.

The forms of the United Kingdom’s withdrawal from the EU is a risk factor that has been with us for quite some time, but if anything, it has increased in strength since Theresa May’s resignation as Prime Minister in June.

The increased political tension between the United States and Iran is another factor that is further fuelling the uncertainty surrounding economic development abroad, as regards the oil price, for example.

The real economy in Sweden has otherwise largely developed in line with our forecasts in April. GDP growth in the first quarter this year was even slightly stronger than our forecast. Over the forecast period, we see an economic slowdown in front of us rather than a recession.

One risk factor as regards the real economy in Sweden is domestic demand. The strong total GDP growth figures for the first quarter conceal continued weak development in household consumption. Despite the labour market still being strong and disposable income developing well, the National Institute of Economic Research’s confidence indicators for households have fallen significantly since the beginning of last year. The pessimism among households must surely be linked to the slowdown on the housing market, but periodically shaky developments on the stock market may also have played a part. Our forecast implies that housing prices will continue to recover and that consumption growth for the coming year will be higher than in 2019. But if housing prices start to fall again, there is a clear risk of lower consumption growth and ultimately slower growth in total demand in the Swedish economy.

As regards housing investment, the subdued housing price growth has left a clearly negative impression. GDP growth this year is heavily burdened by falling housing investment. But according to our forecast, the negative contribution is set to decrease over the forecast period. Just as for household consumption, a new price fall in housing would also risk dampening housing investment substantially.

As regards Swedish inflation, we can note that the outcomes in April and May were entirely in line with our forecasts. CPIF inflation was very close to the target of 2 per cent. Indicators of underlying inflation suggest that it is also around 2 per cent. Energy prices, which have previously increased rapidly, are dropping out of the twelve-month figures in the short term, which explains why CPIF inflation will fall in the short term and then gradually increase again.

There are signs that more companies than normal are planning to raise their prices to consumers. One such sign comes from the responses in our own, most recent business survey.[3] The percentage of consumer-related companies planning to raise their prices during the coming year is continuing to increase. It is also interesting to note that expected price increases in the coming year are being driven by high demand, purchasing costs and labour costs alike.

At the same time, the companies in our survey speak of the tough competition that has arisen as a result of the price transparency in online shopping and that seems to be subduing price growth. An interesting article on companies' pricing behaviour can be found in the most recent business survey. One of the points made in the article is that even though companies tend to increase prices when costs rise, they also show caution due to their anxiety over whether their competitors will do the same.

In summary, I share the assessment of economic development in the draft Monetary Policy Report but also note a growing uncertainty about future global growth. In addition, there are clear uncertainty factors surrounding domestic demand, linked to the development of housing prices. Poorer real economic development in Sweden and accompanying weaker development of inflation than we present in the draft Monetary Policy Report would probably lead to monetary policy needing to be adjusted.

Although the Riksbank still has good possibilities to manage poorer economic development through monetary policy, it is important that we further develop our analysis and continue to follow research as regards the scope for fiscal policy to periodically play a greater role in stabilisation policy when monetary policy has limited room for manoeuvre.[4]

The discussion on the housing market and household indebtedness has continued during the spring. The Riksbank's Open Forum in May this year showed the extent of these issues and the difficulties they entail.[5] Just as before, our assessment is that the high level of household indebtedness is a vulnerability for the Swedish economy that risks creating problems in the event of poorer economic development or a more substantial housing price fall than we have seen so far. The macroprudential policy measures implemented by Finansinspektionen have probably mitigated the risks somewhat, but as they only apply to new mortgages, it will take a long time before the whole mortgage stock is affected by the measures.

Added to this is the fact that the housing market, as it functions today, is hampering efficiency in the Swedish economy, in part as regards the opportunity to move to a new home. As is

[3] See the Riksbank's Business Survey, May 2019.

[4] A new Economic Commentary from the Riksbank discusses this issue in more detail. See B. Lagerwall (2019), "Fiscal policy in a monetary policy perspective", Economic Commentaries No. 5, Sveriges Riksbank.

[5] See https://www.riksbank.se/sv/press-och-publicerat/konferenser/2019/oppet-forum-en-bostadsmarknad-i-balans--vilka-atgarder-kravs/.

highlighted in the draft Monetary Policy Report, it is therefore still important to focus on measures aimed at the fundamental problems on the housing market, including tax rules linked to households' home-ownership, the regulatory framework regarding the construction of new housing and the design of the rent-setting system.

Finally, I would like to say a few words about the reform of the Riksbank's operational framework for the implementation of monetary policy, which is under consideration and described in an article in the draft Monetary Policy Report. It is important to review the operational framework at regular intervals in order to safeguard that monetary policy is implemented so that the short-term market interest rates closely follow the Riksbank's policy rate. The clearer and more transparent we can be, the more understanding and predictability is created on the fixed-income market. The changes we now intend to make are not aimed at altering the direction of monetary policy but at making implementation of monetary policy as efficient as possible.

Deputy Governor Martin Flodén:

I support the proposal to hold the repo rate unchanged, the proposed forecast for the repo rate and the other proposed forecasts in the draft Monetary Policy Report.

Since the monetary policy meeting in April, real economic developments both in Sweden and abroad have on the whole been in line with the Riksbank's forecast. But it has nevertheless been an eventful period. Prior to the monetary policy meeting in April, the picture of continuing low global interest rates over a long period of time to come had strengthened. This development has continued at a faster pace in recent months. The yield on ten-year US government bonds fell by a half percentage point after the monetary policy meeting in April, and yields have fallen in Europe too. Market priced inflation expectations have shifted down rather clearly in several countries, as have expectations of future policy rates. Several central banks have also signalled that monetary policy may need to become more expansionary, albeit not to the same extent as the change in market pricing indicates.

In Sweden, the outcomes for inflation regarding April and May were entirely in line with the Riksbank's forecast. Inflation expectations in Prospera's survey are continuing to show a weak downward trend, but are nevertheless at a decent level. And unlike developments in several other countries, market pricing indicates that the long-term inflation expectations are close to two per cent.

The krona fell after our monetary policy decision in April and has been much weaker than we forecast. I consider this krona depreciation to be illogical and unjustified. Moreover, I do not believe that the krona depreciation helps the Riksbank to stabilise inflation around the target in the longer run.

The krona has appreciated again in recent weeks, and is expected to continue appreciating during the forecast period. Our forecast thus shows both that a krona appreciation is likely and that this type of appreciation is compatible with inflation being close to the target.

I also note that the krona, following the appreciation in recent days, is already stronger than the forecast in the Monetary Policy Report for the third and fourth quarters of this year. I would not be surprised if the krona appreciated a little more when we present this monetary policy decision, with an unchanged forecast for the repo rate. But I would not regard such a krona appreciation as a problem for the Riksbank's monetary policy.

Inflation has now been close to the target for over two years. During this period, rising energy prices have helped to keep inflation up, despite weak inflationary pressures. But in the coming months the contribution from energy prices will probably be negative, and more negative than we assessed at the previous meeting. The forecast for CPIF inflation has been revised down by 0.4 percentage points for June and by around 0.2 percentage points for the coming year. This means that CPIF inflation will probably be closer to 1 than to 2 per cent in the coming months.

On the one hand, this downturn in inflation is somewhat worrying. There are some signs that inflation expectations are already moving downwards, and actual inflation outcomes usually have an impact on expectations. After the problems of the past decade with inflation being too low for a long period of time, there is a risk that confidence in the inflation target has not been completely restored. Expectations may then react more than normal when inflation is low. In that case, it may be more difficult to bring inflation back to the target.

On the other hand, a downturn in inflation caused by a clear and evidently temporary factor should not be problematic. Inflationary pressures have risen recently. The median of the Riksbank's various measures of underlying inflation is 2 per cent. Moreover, our assessment is now that CPIF-inflation excluding energy will be higher in the coming year than was forecast in April. The forecast is that this measure of underlying inflation will rise somewhat during the autumn and then remain close to 2 per cent for the entire forecast period.

To summarise, there is still considerable uncertainty over international economic developments. Moreover, uncertainty has increased with regard to developments in financial conditions and the direction for monetary policy abroad. In Sweden, inflation is still close to the target, but I see a slightly increased risk that inflation expectations will decline in the near term.

The proposal in the draft Monetary Policy Report is to maintain the same forecast for the repo rate as at the monetary policy meeting in April. This means that the repo rate will remain at –0.25 per cent and then be raised towards the end of the year or at the beginning of next year. I think that this is a reasonable forecast. Economic activity in Sweden is strong and inflationary pressures have risen.

The conditions for monetary policy in Sweden nevertheless do not look as bright as they did at the monetary policy meeting in April. I thought then that there were some signs that underlying inflation would strengthen so quickly that it might be appropriate with a somewhat earlier increase in the repo rate than is indicated in the repo-rate path. I now see such a development as less probable.

Finally, I would like to comment on how our repo-rate path compares to market expectations. Pricing on the market indicates that they are expecting a much more expansionary monetary policy than is included in our forecast. This applies to expectations of monetary policy in both Sweden and abroad. It is difficult to reconcile the market's view of future monetary policy with the Riksbank's forecast for the economic outlook and inflation prospects. Pricing on the market presumably builds on a scenario where the economies develop much more weakly. In such a scenario there would hardly be any reason for the Riksbank to hurry to raise the repo rate. On the other hand, I see no probable scenario in the coming quarters where it would be appropriate for the Riksbank to cut the repo rate from its current low level.

Deputy Governor Cecilia Skingsley:

The Riksbank's third monetary policy meeting this year is characterised by a contradictory picture: The economic situation in Sweden is healthy with a historically high employment rate, on-target inflation and a more or less unchanged economic outlook. On the other hand, volatile trading on global financial markets indicates that they are expecting substantially more negative developments in the world economy.

In the global economy, the slowdown over the last year has been given renewed momentum by the continuing conflicts over global trade relations, especially between China and the United States. Confidence indicators have fallen in a large number of countries that are particularly focused on foreign trade in goods.

The financial markets have swayed backwards and forwards over the past three quarters. The announcement at the turn of the year that the US Federal Reserve was to interrupt its monetary policy normalisation provided support to the risk sentiment in the first quarter of this year. But since the monetary policy meeting in April, the financial markets have quite clearly begun to expect that weakened global economic development will lead to new monetary policy stimuli in several of the world's major economies. This realignment of expectations of central banks is particularly evident as regards the Federal Reserve, where the market has positioned itself for rate cuts in the near future, but also as regards the ECB, which is expected to keep to the current interest rate level for the entire forecast period.

Several central banks have also communicated a willingness to conduct policy in accordance with their inflation-targeting task.

At the monetary policy meeting in April, the Executive Board chose to adjust the repo rate path towards a postponement of the next rate rise until the end of the year or the beginning of next year, based on inflationary pressures being seen as weaker than expected and on the gloomier outlook abroad. The pace of rate increases was also adjusted down somewhat.

Since the April meeting, substantial changes in the krona exchange rate have been noted. Firstly a depreciation phase, which then has been almost completely reversed prior to today's monetary policy meeting. Exchange rate changes sometimes lead to intensive debates in society, so I would like to take the opportunity to give my view on the krona's role in Sweden's economic policy framework:

As a result of the Swedish people saying no to the adoption of the euro in a referendum in 2003, Sweden still has a floating exchange rate, an arrangement that has been in place ever since 1992. This means that the Riksbank stabilises purchasing power in Swedish krona via the inflation target of 2 per cent and not by maintaining a fixed exchange rate with another currency. This entire arrangement has been determined by legislation, not unilaterally by the Riksbank. But all in all, it is an economic policy framework that adheres to the same arrangement as in many other small open economies and that seems to work, at least if we consider that Sweden has maintained its ranking of around 10th on the OECD's welfare league table over the last 20 years. Having said that, I would like to add that I have sympathy for those companies and households who are severely affected by exchange rate changes and are experiencing problems. It is also unwelcome for the Riksbank's ability to conduct monetary policy when large and unexpected fluctuations occur in the exchange rate.

Since the monetary policy meeting in April, economic statistics both among important trading partners and in Sweden have developed largely in line with the Riksbank's forecasts, which is an argument for not making any change to monetary policy today. Inflation outcomes have been close to the forecast and the inflation prospects are approximately the same as they were in April. In the months immediately ahead, however, CPIF inflation will fall substantially based on the Riksbank's assumption regarding the development of energy prices. It is expected to bottom out in September at 1.2 per cent. However, the different measures of underlying inflation, which are more informative about the persistence of inflationary pressures, are expected to develop in a way that is compatible with the inflation target. I do not see the expected near-term downturn in CPIF inflation as a problem but anticipate that inflation expectations are sufficiently anchored for the inflation downturn to pass without problems arising with regard to confidence in monetary policy. Should inflation expectations fall significantly in Sweden, however, or other circumstances arise, such as unexpectedly poor activity data or weaker confidence, the forecast for future monetary policy may require adjustment. As I have pointed out previously, the forecast for future interest rate changes must be tested against the outlook for the economy.

Although the macro situation argues for an unchanged monetary policy, international developments have increased the downside risks, that is, developments turning out to be worse rather than better than the forecast.

We are dealing with a cyclically normal slowdown in addition to demand being subdued by ongoing trade conflicts. Although more optimistic signals emerged from the latest meeting of the G20 countries, I anticipate the elevated uncertainty over trade relations to remain for the time being.

Elevated uncertainty for a long time causes the unease over trade to have a structural effect, namely that less favourable trading terms act as a reduction in supply. Poorer conditions for cross-border production reduce the scope for specialisation and thus the conditions for productivity improvements. Monetary policy is not suited to dealing with supply-side problems. Instead, deteriorated trading conditions need to be considered by other economic policies, such as investment in human capital and infrastructure. On the global level, it is unclear what the monetary policy response to reduced demand and supply will actually be. Without structural measures to maintain longer-term growth conditions, however, the pressure on monetary policy to keep up demand will be problematic in many countries. This is particularly true, as the scope for stimulating the economy using only policy rates has decreased in recent years as so-called neutral interest rates have fallen.

Overall, it is reasonable for the Riksbank to exercise caution. Sweden is doing well and monetary policy is doing its job to maintain inflation on target and keep inflation expectations anchored. This is the Riksbank's best contribution to the national economy. I therefore support the proposal to hold the repo rate unchanged and agree that the current repo rate path constitutes a well-balanced monetary policy to keep inflation around the 2 per cent target.

Governor Stefan Ingves:

I support the contents of the draft Monetary Policy Report, I support the proposal to hold the repo rate unchanged at –0.25 per cent, and to hold the repo-rate path unchanged, that is, that an increase in the repo rate can be considered towards the end of the second half of 2019, or early 2020.

Monetary policy also includes managing the government bond portfolio. At the monetary policy meeting in April, the Executive Board decided to purchase government bonds for a nominal value of SEK 45 billion from July 2019 to December 2020. By making these purchases we will largely maintain the level of our portfolio. Our continuing presence on the bond market gives us a good capacity to quickly raise or lower the rate of purchase if there is need to change our monetary policy. The draft Monetary Policy Report contains an article on some intended changes to the operational framework for monetary policy. These changes are of a technical nature and do not alter the content of monetary policy.

The assessments of economic developments abroad and in Sweden made in the draft Monetary Policy Report largely coincide with the assessments made in April. We see ahead of us a fairly good development in global economic activity and also in the Swedish economy.

The global economy has grown rapidly in recent years, and is now entering a phase of lower growth. Our forecasts for the coming years are largely the same as in the previous assessment, which means that we are expecting a growth rate of around 2 per cent in the coming years, if one looks at the countries included in the KIX index, and around 3.5 per cent if one looks at the world in total. Growth in the euro area, which accounts for half of the KIX index, has been lower than in both the United States and Sweden, and this will continue throughout the forecast period. Inflationary pressures abroad have been moderate in recent years, particularly in the euro area, but are expected to rise slowly during the forecast period. According to our forecast, a rising rate of inflation abroad is an important starting point for Swedish inflation to continue developing in line with the target.

All in all, the changes in our quantified forecasts are not so large. But the risk outlook has worsened since the monetary policy meeting in April. The trade conflict between the United States and China deteriorated again in May, but after the G20 meeting in Osaka the tone is more positive. It is difficult to foresee whether this might be the start of more stable trade relations between the United States and China. The United States and China together account for around 40 per cent of the world's GDP and stable economic relations between the two are of course important for the global economy. Here in Europe there is still uncertainty over the United Kingdom's withdrawal from the EU. In the euro area, the complicated discussions between the Italian government and the EU are continuing. One concern here is Italian banks, but unfortunately the banking sector looks weak in other euro countries, too. In other words, there is a large number of risks that could have a significant effect on economic developments. But the risks I mentioned now are very difficult to quantify and are only built into our forecasts when they materialise.

Turning to developments in Sweden, it can be noted that economic growth in the first quarter of this year was unexpectedly high, 2.4 per cent as a quarterly change, calculated in annualised terms. The forecast for GDP growth in 2019 is 1.8 per cent, somewhat higher than the assessment in April. The forecast for 2020–2021 is a growth rate just under 2 per cent, slightly lower than was forecast in April. The revision is due to fewer new housing starts, among other things. But the forecast revisions are relatively small, and the picture of continued good economic activity still stands. The labour market has been strong for several years, with labour force participation and employment at historically high levels.

Inflation continues to develop in line with our target of 2 per cent. The outcomes since the previous monetary policy meeting have been in line with the forecasts in the April Report. The most recent observation concerns inflation for May, when the annual percentage change in the

CPIF was measured at 2.1 per cent. The inflation forecast for the coming year has been revised down somewhat, partly due to lower energy prices. But the changes in the forecasts are minor and inflation prospects can be said to be largely unchanged. Target attainment continues to be good, and inflation expectations indicate high confidence in the inflation target.

The development of the Swedish krona has been unexpected. Following the monetary policy meeting in April, the krona weakened, contrary to our forecast that it would strengthen. The new krona forecast is weaker than the previous one for the entire forecast horizon. I have previously said that we should review our analysis of the exchange rate. When it comes to exchange rates one has to differentiate between nominal and real exchange rates, between bilateral and multilateral. Our analysis of the direction of the Swedish krona mostly concerns what the total development is expected to be. And we then begin with the real exchange rate, that is, how relative prices expressed in the same currency can be expected to develop in the longer run. An article in the draft Monetary Policy Report reviews different ways of measuring the real exchange rate and points out that different measures paint slightly different pictures. The article also describes the traditional model commonly used to explain the historical development of exchange rates. The traditional model highlights factors such as differences in growth between countries and the current account, that is, how the price of a country's exports develops in relation to the prices of the goods it imports. This type of analysis indicates that the krona's real exchange rate will strengthen during the forecast period. As different measures lead to different conclusions, it is an open question how much the krona can be expected to strengthen.

But to better understand the nominal development of the krona, not least bilaterally against the euro, I believe that the traditional approach may need to go deeper, with more detailed analyses of the different components of the current account, and that it may also need to be supplemented with other, more financially based approaches. Here I am thinking about explanatory models that give more explicit consideration to the global financial markets having undergone major changes over the past decades. The turnover on various financial markets has grown, at the same time as there are signs of increased fragmentation. Changed behaviour among major global investors can also have led to small currencies like the Swedish krona developing in a different way than before. Nor does it require very much international unease before small currencies are affected and then the exchange rate may turn out quite differently than expected.

Where are we now in terms of our monetary policy? In December last year the policy rate was raised to –0.25 per cent, after being at –0.5 per cent for almost 3 years. The reason we raised the policy rate then was that the very expansionary monetary policy, which also included extensive purchases of government bonds, had had the intended effect and inflation was developing in line with the target of 2 per cent. The repo-rate path we published in December showed further rate increases ahead, but at a cautious pace. In April, we changed this plan somewhat after some weak inflation outcomes and we reduced the pace of the rate increases. Developments since April have been largely as we expected, and it is now proposed that the repo-rate path is held unchanged, with slow increases in the repo rate during the forecast period. The bond purchases over the coming 18 months will mean that we maintain the bond portfolio at a fairly stable level. To summarise, monetary policy will remain very expansionary during the forecast period with a few more years of a negative real interest rate.

But there is a risk outlook, as I mentioned earlier. If the markets are right, the major central banks may turn their monetary policy around, into a more expansionary direction. If this is the case, we will need to take a stance at our future monetary policy meetings on what it means for monetary policy in Sweden. It is much too early to draw any decisive conclusions, but one can observe that when, for instance, the ECB turned its monetary policy around, into a more expansionary direction a few years ago, we were in a different situation, with low inflation and low inflation expectations. We are in a better place now, and therefore have a greater degree of freedom. Pricing on the fixed-income markets in many countries is pointing to low, or lower, interest rates for a long time to come. The real economic forecasts are not pointing in that direction. There the picture looks much better. It is difficult to see how such tangibly different views of future developments can be brought more into line, but this indicates a rather interesting autumn ahead.

I would once again like to conclude by reminding everyone of the risks linked to the high household indebtedness. In the draft Monetary Policy Report household debt as a share of disposable income is expected to continue to rise in the coming years, and this makes households even more sensitive to different kinds of unexpected change. The rising indebtedness is linked to developments on the housing market. Addressing these risks and the structural problems on the Swedish housing market requires measures within housing and tax policy. Without reforms and with a continued expansion of debt, the risks in the entire economy will increase at the same time as macroprudential policy measures will then need to be tightened and monetary policy will have to give greater consideration to the risk outlook. This would result in a policy mix that is far from first best.

Deputy Governor Henry Ohlsson:

To begin with, I would like to say that I support the proposal to leave the repo rate unchanged at –0.25 per cent.

Annual growth abroad, KIX-weighted, is expected to amount to 2.0 per cent in 2019 according to the draft Monetary Policy Report. The forecast is unchanged since the monetary policy report in April. For 2020 and 2021, the forecast for both years is also 2.0 per cent. According to the draft Monetary Policy Report, KIX-weighted inflation is expected to be 1.9 per cent in 2019. Also in this case, the forecast remains unchanged compared with the Monetary Policy Report in April. The forecasts for 2020 and 2021 are 1.9 per cent and 2.0 per cent respectively. According to the draft Monetary Policy Report, the weighted average of international policy rates is expected to be the same in 2019 and 2020 before increasing slightly in 2021. Overall, I think this must be considered a good international development.

The CPIF has been the target variable for monetary policy since 2017. The most recent inflation figure in May showed an annual rate of increase in the CPIF of 2.1 per cent. CPIF inflation has been around the inflation target for an extended period of time. Over the last 26 months, it has been in the interval 1.7–2.5 per cent. The average rate of inflation over these 26 months has been 2.1 per cent. According to the forecast in the draft Monetary Policy Report, the annual rate of inflation will be 1.7 per cent in 2019. In 2020, the CPIF is expected to increase by 1.8 per cent as an annual rate and in 2021 by 1.9 per cent. Although this is a downward revision for 2019 compared with April, I consider this to be within the margin of error and that target attainment is still good!

The June reading of five-year inflation expectations among money market participants was 1.9 per cent. Over the last 42 months, the mean value of five-year expectations has been 1.9 per cent or higher. Inflation expectations are well anchored!

Over the past year, we have had a further example of uncertainty linked to individual observations of key macroeconomic variables. The GDP outcome for the third quarter of 2018 was weak. But when GDP data for the fourth quarter of 2018 was published, the outcome was strong. Since the last monetary policy meeting, GDP data has been published for the first quarter of 2019. Even in this case, the outcome is strong. In the draft Monetary Policy Report, the forecast for GDP growth in 2019 is now being revised up to 1.8 per cent, from 1.7 per cent in April. It should be noted, however, that there has been a downward revision for 2020.

According to the most recent labour force survey (LFS), unemployment was 6.8 per cent (not seasonally adjusted) in May. This is higher than the corresponding month one year earlier, when LFS unemployment was 6.5 per cent. Although individual monthly figures should be interpreted with caution, the conclusion is that LFS unemployment has bottomed out.

At the same time, I think it is important to also look at other measures of unemployment when interpreting the LFS. Unemployment insurance fund members can be considered to have a relatively strong position on the labour market. In May 2019, the percentage of openly unemployed fund members was 2.6 per cent. This is slightly higher than in the same month one year previously, when the proportion was 2.4 per cent. A few tenths of one per cent here or there makes no great difference, but qualitatively, it is interesting that the downward trend that we have seen for several years has now been broken. The break in the trend emphasises that unemployment has now bottomed out.

In my opinion, however, unemployment is still too high. But today it is primarily a matter of bringing down unemployment among foreign-born persons. And this is not firstly a question of general demand policy but rather of labour market policy measures to strengthen the human capital of unemployed persons and cut the cost of employing them.

Against the backdrop of this reasoning, I would now like to move on to my monetary policy considerations: My starting point is that monetary policy cannot be governed by inflation varying a few tenths of a percentage point around 2 per cent in individual months. Inflation has now been around the target of 2 per cent for quite a long period of time, both with regard to outcomes and expectations. This was the decisive argument for me in December 2018 that it was time to start raising the repo rate.

The repo-rate path that was decided on in December 2018 entailed around two rate increases per year during the coming years, with an initial increase during the second half of 2019. At the monetary policy meeting in April, I saw no crucial reasons for departing from this, as there was no argument against the programme we established in December. I would therefore have preferred to left the repo rate path unchanged at the April meeting.

Market reaction to the monetary policy decision in April to depart from the December plan by moving the rate path forward and also continuing to purchase government bonds was strong. The krona exchange rate depreciated substantially. This is not surprising since one of the channels through which monetary policy works is the exchange rate channel. And since the shift in monetary policy was a surprise, the exchange rate effects were also significant.

When I now look at developments since April, it is my view, as it was at the monetary policy meeting in April, that no new data has emerged that gives reason to make monetary policy more expansionary. The draft Monetary Policy Report predicts a slowdown both in Sweden and internationally, but this was already incorporated into the forecasts in December. And trade wars, the United Kingdom's withdrawal from the EU, the Italian economy, etc., were already uncertainties in December and are not new developments. At every monetary policy meeting, there will always be phenomena that give rise to uncertainty. I cannot imagine a situation where the future is certain in all respects. Uncertainty is something economic policy always needs to live with. We can always find something to worry about if we want to.

In light of this reasoning, I therefore consider it to be appropriate at this monetary policy meeting to leave the repo rate path unchanged. Even though I would still prefer December's rate path, what has been done cannot be undone. I am not therefore entering a reservation on this point. However, I would like to say that the issue of whether a rate rise in my opinion could become relevant as early as at the September or the October meeting is for me an open question.

This time, I can support the economic picture and the forecasts in the draft Monetary Policy Report.

§4. Monetary policy decision

The Executive Board decided

- to hold the repo rate unchanged at –0.25 per cent and that this decision shall apply with effect from Wednesday 10 July 2019.
- to adopt the Monetary Policy Report according to the proposal, Annex A to the minutes.
- to publish the Monetary Policy decision and the Monetary Policy Report with the motivation and wording contained in a press release at 09.30 on Wednesday 3 July 2019, and
- to publish the minutes from today's meeting at 09.30 on Friday 12 July 2019.

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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