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Minutes of the Executive Board's Monetary Policy Meeting, No. 5

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TIME: 9 a.m.

■ PRESENT: Stefan Ingves, Chairman
Karolina Ekholm
Lars Nyberg
Lars E.O. Svensson
Barbro Wickman-Parak
Svante Öberg

Leif Pagrotsky, Vice Chairman of the
General Council

Sigvard Ahlzén
Hanna Armelius
Claes Berg
Heidi Elmér
Eric Frieberg
Jesper Hansson
Ann-Christine Högberg
Martin W Johansson (§1)
Anna Lidberg (§1)
Pernilla Meyersson
Marianne Nessén
Christina Nyman
Bengt Pettersson
Britta von Schoultz
Staffan Viotti
Daniel Westin (§1)

§ 1. Economic developments

It was noted that Hanna Armelius and Bengt Pettersson would prepare the necessary draft for monetary policy meeting minutes with regard to paragraphs 1, 2 and 3 on the agenda for the meeting.

Martin W Johansson of the Financial Stability Department began by presenting recent developments regarding financial stability. Both Swedbank and SEB have recently published interim reports for the third quarter. Swedbank made a loss of more than SEK 3 billion, partly as a result of loan losses in the Baltic countries and Ukraine. However, loan losses were slightly lower than during the second quarter, and the loan losses in Sweden are small.

During the third quarter SEB made a profit of SEK 37 million, despite loan losses of just over SEK 3 billion. SEB is not extending its participation in the government's guarantee programme.

Anna Lidberg of the Monetary Policy Department reported on developments in the financial markets since the Executive Board Meeting in September. Swedish government bond rates have fallen slightly and the krona has weakened. Equity markets have continued to rise. Interest in the Riksbank's loans has declined, both with regard to the SEK loans and the USD loans. Monetary policy expectations remain largely unchanged since the September monetary policy meeting. Market information provides a uniform picture of expectations that the interest rate path will be held unchanged at the monetary policy meeting. However, surveys of end investors indicate expectations that raises in the interest rate will come sooner than is indicated in the interest rate path published in September, and that no further fixed-interest rate loans will be offered.

Jesper Hansson of the Monetary Policy Department presented a summary of the background material for the Executive Board's discussion. He noted that the turnaround in the world economy and in Sweden appeared to be confirmed. The fall in GDP slowed down during the second quarter in Sweden and abroad. We see signs of a large cutback in stocks, which is a positive factor for future growth. Confidence indicators are continuing to rise and there is optimism in the financial markets. Credit spreads have continued to fall, but with continued support to the financial markets from central banks and governments around the world. Employment in Sweden has developed in line with the forecast made in September. Energy prices have fallen, although there has been some upturn in oil prices recently, and inflation and the exchange rate have developed in line with the forecast. The main scenario in the draft Monetary Policy Report entails resource utilisation being much lower than normal during the period 2009-2011. The recovery is from a low level, following the large fall in the world economy and in Sweden. Underlying inflation, adjusted for mortgage rates, is expected to be stable, while there are expected to be large fluctuations in CPI inflation as a result of the repo rate path. The forecast for GDP growth in Sweden has been revised upwards, but at the same time, the inflation forecast has been revised down slightly. It is suggested in the main scenario that the repo rate should remain at 0.25 per cent and later be raised to more normal levels, starting in autumn 2010. It is also proposed that further loans be offered to the banks at a fixed interest rate and with a maturity of 11 months. The alternative scenarios in the draft Monetary Policy Report include a faster global recovery, lower cost pressures in Sweden, an interest rate path in line with market pricing and a scenario where the repo rate is set at zero.

§ 2. Economic outlook abroad

Deputy Governor **Lars E.O. Svensson** began the discussion by pointing out that he shares the view of developments abroad contained in the draft Monetary Policy Report. However, he emphasised that even if the prospects for the world economy have improved somewhat since September, it is still important, as it was in September, not to count too much on the positive signals that can be noted. As in September, it is still important and desirable that the monetary and fiscal policy conducted around the world should continue to be expansionary. The risks of breaking off the expansionary policy too early are still much greater than the

risks of continuing too long with it. It is important not to repeat what various analysts see as the classical policy mistakes made in the United States in 1936 and in Japan in 1996.

First Deputy Governor **Svante Öberg** also agreed with the picture of international developments presented in the draft Monetary Policy report. It is reasonable to revise up the forecasts for international growth. However, despite the upward revisions, growth in the United States and Europe is expected to be moderate in 2010.

The situation in the financial markets has improved substantially. Risk premiums measured as TED and basis spreads have come down to normal levels, or almost normal levels, in both the United States and Europe, the bond markets have begun to function again and the Swedish banks have strengthened their capital bases. The stock markets have strengthened and the volatility in the stock markets has declined.

At the same time, the financial systems are still dependent on support from government and central banks. According to the International Monetary Fund's, the IMF's, most recent report in October this year, the banks in the United States have only reported just over half of the estimated loan losses and the European banks less than this. Moreover, the banks will endeavour to reduce their balance sheets and new regulations will probably be introduced increasing capital adequacy requirements, which will subdue lending in the future and have a restrictive effect on demand.

The IMF also has an interesting analysis of developments since the crisis in its most recent report. They note in the October report that GDP in 2010-2012 is expected to be around 10 per cent lower than according to the medium-term forecasts made in April 2007. According to the IMF, this is consistent with experiences from previous financial crises. Dividing up the long-term fall in GDP following previous crises indicates that employment and total factor productivity will decline substantially during the first two years, but that employment will recover in the longer term, while total factor productivity will remain lower even in the longer term. The negative consequences of the crisis are moreover reinforced by the decline in capital intensity caused by lower investment.

It will take time before GDP in various countries has reached the same level as prior to the beginning of the crisis and even when the GDP level prior to the crisis has been attained, this is far below what a trend projection from the 2007 level would entail. In the United States the GDP level that prevailed prior to the crisis will be reached at the end of 2010, according to the forecasts in the draft Report, while for the euro level it will take until 2012 before this level is attained.

It will also take time before the labour markets normalise. According to the IMF, unemployment will peak in 2010 and in 2014 it will not have come down to the level prior to the crisis in the euro area, while unemployment in the United States, with its more flexible labour market, is expected to have reached the level prior to the crisis then.

Domestic inflationary pressures will thus probably be low in the coming years. On the other hand, rising oil and other commodity prices resulting from the rapid growth in Asia and emerging economies in other parts of the world will push up consumer prices.

Asia has also been hit by the global financial crisis, but has managed relatively well thanks to being less dependent on financial markets and powerful stimulation packages. Although China and India have lower growth this year than previous years, they have avoided a

recession. GDP growth in both China and India is expected to increase next year, according to the IMF, and to help push up growth in other countries in the region. Japan is also expected to show positive growth next year.

The situation in the Baltic countries, in particular Latvia, will remain vulnerable next year, and there is still a risk of an even poorer outcome than the Riksbank has forecast. According to the IMF, GDP in the Baltic countries will fall by a good 20 per cent between 2007 and 2010, mostly in Latvia and a little later in Lithuania. Latvia in particular, but also Lithuania, is experiencing significant problems with rising unemployment and large deficits in public finances. On the other hand, the earlier problems with high inflation and large current account deficits will change into expected negative inflation and surpluses on current accounts next year.

Deputy Governor **Karolina Ekholm** pointed out that the picture of a recovery has been further reinforced. As Jesper Hansson mentioned in his presentation of the draft Monetary Policy Report, there have been rather mixed signals, for instance, weak GDP outcome for Denmark, but this can be expected when recovering from such a deep recession.

It is clear that the economies in Asia are faring better than in other parts of the world and that China is functioning as the driving force for several of them. Ms Ekholm considered that things looked much more fragile in the United States and Europe, although the signs of a recovery have strengthened there, too. Demand is currently being held up by strong monetary policy and fiscal policy stimulus and it is unclear when these can be phased out without any risk of the recovery being broken off. She agreed with Mr Svensson that it is important not to phase out the measures too soon so that the recovery is affected.

There are a couple of concerns regarding economic prospects abroad. One of these is the substantial weakening in government finances in many large economies such as the United States and the United Kingdom. Another that has significance for Sweden is developments in the Baltic countries. Things still look fairly gloomy with regard to developments in the Baltic economies.

Ms Ekholm said that one important factor in future was to what extent the global imbalances would decline. There has been and still is strong pressure on countries with surpluses to take measures to reduce their current account surpluses. In China some measures have been taken to stimulate domestic demand in the short term, and there are plans for reforms that can reduce the saving ratio there more permanently. With regard to countries with current account deficits, it is reasonable to expect increased household saving in the United States, but the increased budget deficit and thereby decline in the public sector financial balance will hold back aggregate saving in the short term. It is difficult to assess what will happen in the longer term, but one can note that the trading pattern appears to have altered somewhat during the crisis. For instance, there has been an increase in China's share of Swedish exports and during the first half of 2009 China was one of the ten most important markets for Swedish exports of goods. On the import side, the share from the United States increased, making the United States one of the ten most important sender countries for imports of goods to Sweden.

Governor **Stefan Ingves** began by saying that since the previous monetary policy meeting the signs of a recovery in international economic activity had continued to appear. This applies firstly to Asia, secondly to the United States and then to Europe. It is clear that the

expansionary fiscal and monetary policy is having an effect. However, we can expect a slow recovery. The composition of demand in the world will be different in the future. Potential production will probably be lower. Many people have become unemployed and risk losing some of their competence, and the capital stock is not adapted to the new type of production. This applies both in Sweden and abroad.

Mr Ingves pointed out that there are also differences between countries as a result of the possibility for fiscal policy stimulus being different in the light of different initial public finances. Some countries will therefore be forced to conduct more restrictive fiscal policy in the future, which may curb the recovery. It will take several years before GDP once again reaches the level prior to the financial crisis, and some potential production has been lost. Historically, large imbalances and financial crises appear to lead to a longer recession than in a normal economic downturn. One example of this is our own financial crisis at the beginning of the 1990s.

One important factor for the development of Swedish exports is how the problems in the financial sector in Europe are managed. The possibility to offer loans in Europe is affected by the ability or willingness to manage recapitalisation of the banks, which can in turn affect growth. Mr Ingves referred to Mr Öberg's comment on the IMF's assessment that many indications are that loan losses in the United States and Europe have not yet peaked. There has been a transition from a liquidity crisis with frozen markets to a classical management of bad loans. This means that credit granting to the private sector will be tightened. Sweden is an exception here, although credit growth to households and companies has declined. However, we will not know for certain until next year what will happen with credit granting in Sweden and abroad.

One positive factor for the world economy is that there are signs that the global imbalances have begun to be corrected. The current account deficit in the United States has declined significantly and the same applies to the surpluses in Germany, Japan and the oil-producing nations. When this happens, which is in itself necessary, there will be a redistribution of global demand, which is one reason why the recovery will be slow. This will affect developments in a small, trade-dependent economy like Sweden's.

Deputy Governor **Lars Nyberg** began by saying that since the monetary policy meeting in September the situation in the international financial markets has continued to improve. This is a continuation of the positive developments since last spring and which have gradually gained in strength. In this context he wished to point out three factors that were particularly significant. Firstly, risk premiums, as measured in the spreads, have fallen further and are back to largely normal levels on many markets. And he did not count the period prior to 2007, with unnaturally depressed risk premiums, as normal. Secondly, the volumes traded on the market have increased substantially. This applies in particular to the bond markets in Europe and in the United States, where the volumes issued have been record-high. Several markets that were previously closed are becoming active again. Thirdly, the demand for support from the central banks has declined around the world. This is possibly the most important sign that the markets are regaining their health, as it shows that the financial system in the world is slowly attempting to get back on its feet.

But Mr Nyberg emphasised that even if the situation has improved, this does not mean the crisis is over. Many markets are still strongly dependent on central bank measures.

Moreover, a number of markets are still functioning poorly, for instance, the markets for products that are difficult to evaluate, and which at one point gave rise to the crisis. And these markets should perhaps remain closed. But the poor functioning causes problems for many banks, although not the Swedish banks, which still have balance sheets filled with financial instruments that are difficult to sell. It also limits the banks' opportunities to lend money, which causes problems for the countries where the banks are active. Moreover, substantial loan losses remain, and these will also affect the banks' balance sheets. The size of the total expected loan losses is now considered to be known, at a rough estimate, so the uncertainty that has affected confidence in the markets in this respect has declined significantly.

In addition, Mr Nyberg claimed that the method and speed for the central banks' exit strategies is now an important question that is creating uncertainty in the markets and thus affecting pricing. If the measures are withdrawn too quickly, this could cause significant disruptions. Mr Nyberg referred to Mr Svensson's examples of the United States in the 1930s and Japan in the mid-1990s where policy was tightened too soon. However, this concern may be exaggerated. There are also a number of historical examples where the stimulation measures remained in place too long. It is in the interests of the central bank that the markets should continue to recover and there is no reason to hasten the exit strategy if this would create problems.

With regard to the international forecasts, Mr Nyberg largely, though not completely, shared the view presented in the draft Monetary Policy Report. He pointed out that it is now the second time that the forecast for international growth has been revised upwards, which has been due to the outcomes we have noted being slightly better than we had expected. Mr Nyberg considered that, as at the previous meeting, this was because the Riksbank had underestimated the effects of the financial markets having begun to recover, just as, at the end of last year, the effects of the earlier unprecedented tightening were underestimated. According to Mr Nyberg the forecast in the main scenario is once again a little too cautious, particularly with regard to growth in the coming year. The developments seen during the autumn could have justified a slightly stronger forecast.

Deputy Governor **Barbro Wickman-Parak** began by commenting that she did not intend to describe developments in the financial markets, as several other members had already done so. However, she agreed with Mr Nyberg on the importance of confidence having returned. This is important because the lack of confidence has lain over the economies like a wet blanket. In the same way as we have previously underestimated the scope of the decline in the world economy, we now risk underestimating the upturn. The correction in the global imbalances has begun, as the current account deficit in the United States has declined, and the trend seems to be the same for the surplus in China. However, this is a process that will take time. Ms Wickman-Parak referred to earlier contributions to the debate by Mr Öberg and Ms Ekholm regarding the problematic developments in the Baltic economies. She emphasised that the improvement in the global economy should also have a positive effect on the Baltic countries.

Ms Wickman-Parak stated that the upward revision to the international forecast at the monetary policy meeting in July was extremely marginal but that the revisions made in September and on this occasion were slightly larger. Her assessment in July and September was that international growth would take an upward turn at the end of the current year and

during the course of 2010 become stronger than in the previous main scenarios. Now the forecast for growth in the second half of the year in particular has been revised upwards. There has also been some upward revision to the forecast for the beginning of next year. While she welcomed these revisions, her view was still that global growth in 2010 would be slightly stronger than in the main scenario of the Monetary Policy Report. The draft report contains an alternative scenario with a stronger growth forecast and, without adopting this scenario, she said that she would nevertheless have liked to see a further upward revision of international growth like this. Ms Wickman-Parak mentioned that what she had seen of the statistics, both outcomes and indicators, could be interpreted to support her opinion. While there had been a number of mixed signals, it was highly unusual that setbacks did not arise in indicators during an upturn phase, and this was how it could look in the future. The main tendencies were still positive, however.

The stocks cycle contributes to an upward revision in the forecast for international growth this year and there have been numerous discussions as to whether final demand will follow when the stocks effect peters out. However, every recovery usually begins with an upswing in the stocks cycle, followed by increased production. This generates greater income, which supports demand. We have now also seen manufacturing output increase in the United States from a strongly depressed level. It increased by just over 5 per cent in the third quarter, compared with the second quarter, when calculated as an annual rate. In the euro area, too, manufacturing output has begun to recover slightly in recent months.

Ms Wickman-Parak also pointed out that a very broad indicator, namely the OECD's leading indicators for August, which was published a week or so ago, points to continuing stronger signs of a recovery. The OECD's compilation for the countries that have leading indicators of this type shows that the recovery has a large geographical spread. The aggregate indicator has continuously and rapidly recovered since February. In addition, figures such as industrial output in the OECD area have risen since April. During the past three months, up to the end of July, the increase has been 6.5 per cent compared with the previous 3-month period, when calculated as an annual rate. There are thus plenty of indicators showing that the countries of the world are recovering in unison from the unusually deep economic recession which they fell into in unison.

Ms Wickman-Parak went on to say that there is now a discussion on what will happen to growth once the effects of fiscal policy stimulus measures have petered out. An interesting phenomenon is that one has hardly had time to discover that the measures have begun to take effect when concern is voiced in the debate over what will happen when the effects wane. It is not so very long ago that the debate concerned whether the measures would have any effect at all. But this concern should probably not relate to 2010, it is rather 2011 and 2012 that may be in the danger zone. She assessed that there was little risk that central banks would begin to tighten their policy quickly. There was probably no risk either that governments would withdraw stimulus measures for next year that they had already decided on.

Finally, Ms Wickman-Parak said that even with her slightly more optimistic view of developments abroad, she did not envisage a rapid return to the fast growth rate prevailing prior to the crisis. There are several restraining factors. In the United States, for example, households have increased their saving and this will probably increase further. US consumers will probably not act as growth engines for the rest of the world to the same extent as

before the crisis. Given the low resource utilisation in most countries, it will probably take some time before investment fully recovers. This means that the demand for credit will probably not expand rapidly. Unless there are setbacks in the financial markets, it should be possible to meet the need for credit arising there. It can also be noted, as Mr Nyberg mentioned, that issue volumes in the markets have accelerated now.

Governor **Stefan Ingves** summarised the discussion on international developments by saying that some members expressed the opinion that global growth could be stronger than is assumed in the draft Monetary Policy Report. There was also in some quarters an impression that downside risks exist. All in all, however, he found that there was support for the assessment in the draft Report.

§ 3. Economic developments in Sweden and the monetary policy discussion

Deputy Governor **Lars E.O. Svensson** began the discussion by mentioning that with a flexible inflation-targeting policy, monetary policy is aimed at stabilising both inflation around the target level and resource utilisation around a normal level. It is important that this statement is not misunderstood. This statement is still misunderstood at times, despite having been made on many occasions over a long period of time. Does it mean that monetary policy has one objective or two? Here it is important to distinguish between the average level and the stability/variability around the average level.

When it comes to the average level, the Riksbank has only one objective, a target of 2 per cent for CPI inflation. The Riksbank does not have any objective or target for average/normal resource utilisation. This is instead determined by the functioning and structure of the economy, as well as by the economic policy that affects the structure and functioning of the economy. A few decades ago it was not unusual for monetary policy to have explicit or implicit targets for average employment and production, targets that were often unrealistic and, for instance, aimed at an employment rate that was higher than the sustainable rate given the functioning and structure of the economy. The results of this are frightening. There was no higher employment level than normal, but there was high and fluctuating inflation. A deep recession was often required to bring down inflation. Monetary policy should therefore not have any target for resource utilisation. One could say that when it comes to level, there is a hierarchical objective, more precisely only one single target, which is for inflation.

It is different when it comes to the stability of the inflation rate around the inflation target and resource utilisation around a normal level. Then monetary policy aims to stabilise both inflation around the inflation target and resource utilisation around a normal level. One can say that with regard to stability there is what is called a dual objective. Put differently, monetary policy has one target, the inflation target, but two target variables, which it aims to stabilise, namely inflation and resource utilisation. With this distinction between level and stability there need be no lack of clarity regarding the aim of monetary policy. The draft Monetary Policy Report contains a very elucidatory article on how monetary policy alternatives can be evaluated in this context.

Mr Svensson pointed out that monetary policy aims to stabilise both inflation around the inflation target and resource utilisation around a normal level. It is a matter of finding a repo rate path that gives a “well-balanced” monetary policy. If there is a conflict between stabilising inflation and stabilising resource utilisation, then a well-balanced monetary policy involves a reasonable compromise between the stability of inflation and the stability of resource utilisation. If there is no such conflict, things are much simpler. Then it is merely a question of finding the repo rate path that will best stabilise both inflation and resource utilisation. At present, as at the monetary policy meeting in September, one can actually claim that there is no conflict, that inflation stability is no problem, and that monetary policy can focus on stabilising resource utilisation in the best possible manner. One can also claim that resource utilisation is best stabilised by an interest rate path that is lower than the one in the main scenario.

This draft Monetary Policy Report contains a main scenario with a repo rate path that agrees with the main scenario in the September Monetary Policy Update, that is, it has a repo rate of 0.25 per cent up to autumn 2010. This gives a forecast for CPIF inflation that is rather low during the forecast period, and a forecast for resource utilisation that is very low and will remain low throughout the forecast period.

In general, when it comes to determining whether a particular interest rate path entails well-balanced monetary policy, it is a matter of showing that a higher or lower interest rate path will all in all provide poorer stabilisation of inflation and resource utilisation. In this case the draft Monetary Policy Report contains such an analysis at the end of Chapter 2. There it is shown that a higher repo rate path, more precisely a repo rate path that is roughly in line with market expectations of the future repo rate path leads to a forecast for resource utilisation that is lower than the main scenario and hence gives an even poorer stabilisation of resource utilisation around the normal level. The higher repo rate path also gives a forecast for CPIF inflation that is lower than in the main scenario and further from the inflation target and which also gives a poorer stabilisation of inflation around the inflation target. A higher repo rate path thus leads to much poorer monetary policy.

This is illustrated very clearly in the article “Evaluation of different monetary policy alternatives” and by Figure B1 on page 48. This shows the mean squared gap for the inflation forecast, a measure of the deviation of the inflation forecast from the target, and the mean squared gap for resource utilisation, a measure of the deviation from the resource utilisation forecast from a normal level. Both of these are much higher in the alternative with a higher repo rate path than in the main scenario.

This higher repo rate path also demonstrates the problem of market expectations of the future repo rate path being higher than the Riksbank’s published repo rate path, which has been the case since April. If market expectations of the future repo rate path differ from the Riksbank’s published repo rate path, it is the market expectations that will apply and determine the actual market rates at longer maturities and thereby the actual monetary policy. If market expectations are higher than the Riksbank’s repo rate path, the actual monetary policy will be tighter than the intended monetary policy, resulting in lower inflation and lower resource utilisation. This shows the importance of gaining credibility for the Riksbank’s repo rate path and bringing down market expectations of the future repo

rate. According to Mr Svensson, there are two means of bringing down market expectations of the future repo rate, loans at longer maturities and a fixed interest rate or a lower repo rate path.

It is thus clear that a higher repo rate path than in the main scenario all in all leads to poorer stabilisation of both resource utilisation and inflation. What happens with a lower repo rate path? The answer to this question is also given in the analysis at the end of Chapter 2. There it is demonstrated that a lower repo rate path than in the main scenario will give both a higher forecast for inflation that is closer to the inflation target, and a higher forecast for resource utilisation that is still low, but not quite as low. As in September, a lower repo rate path than in the main scenario would better stabilise both inflation and resource utilisation.

This is also shown clearly in Figure B1 on page 48, where the mean squared gap for both the inflation forecast and resource utilisation forecast becomes lower with a lower repo rate. The difference is small for the inflation forecast, and less important, but it is greater for resource utilisation and there it is important.

As monetary policy aims to stabilise inflation around the inflation target and resource utilisation around the normal level, and the low repo-rate path stabilises both inflation and resource utilisation better than the repo rate path in the main scenario, Mr Svensson advocated a lower repo rate path, where the repo rate is cut to zero and held at this level until the third quarter of 2010, instead of the repo rate path in the main scenario. He also wished to point out that he supports the proposal for loans at a fixed interest rate. He did not consider a lower repo rate path to be any problem for the functioning of the financial markets or for financial stability.

How much can be won by having a low repo-rate path rather than that in the main scenario? The draft Monetary Policy Report states an average improvement in the labour market gap of a modest 0.1 percentage points during the forecast period, that is, around 5,000 jobs. Mr Svensson said this figure was too low. To start with, it can be seen in Table A12 that the labour market gap with a lower interest rate falls by 0.2 percentage points less. This corresponds to 10,000 jobs saved. Furthermore, these calculations have been made with the aid of a series of so-called unexpected deviations from the main scenario, which correspond to a situation where the Riksbank does not announce a lower repo rate path in advance, but instead surprises the market by unexpectedly following a lower repo rate path each time a decision is made. If one instead makes the calculations assuming expected deviations from the main scenario, the effects on employment and unemployment are greater, he claimed. Mr Svensson's assessment was that a lower repo rate path could save between 10,000 and 25,000 jobs in the coming years, which is quite a lot.

Deputy Governor **Karolina Ekholm** said that she supported the proposal to hold the repo rate unchanged at 0.25 per cent and the repo rate path contained in the main scenario of the draft Report. She claimed that there are now also in Sweden clearer signs of a recovery. It is therefore reasonable to make an upward revision to the GDP forecast in the draft Monetary Policy Report. However, inflation has been weaker than expected and the inflation forecast has been revised down slightly. Once again the revision tendencies for GDP and inflation are giving contradictory signals for monetary policy – the upward revision

in the forecast for GDP growth points to slightly tighter monetary policy while the downward revision in the inflation forecast points in the opposite direction.

All in all, Ms Ekholm thought that developments in the Swedish economy looked slightly better. However, she pointed out that the very weak resource utilisation meant that she did not see any reason to tighten monetary policy. The forecast in the draft Report assumes not only that the Swedish economy has a large surplus of spare capacity now, but also that there will be a surplus during in principle the entire forecast period. Inflation is no problem as long as inflation expectations are so low that monetary policy does not need to be tightened to attain the inflation target. Ms Ekholm therefore did not see any reason to raise the repo rate or change the forecast for the repo rate to an earlier raise. She thus advocated that the repo rate and the repo rate path be held unchanged.

Ms Ekholm said that it could of course be the case that the recovery came sooner than was predicted in the main scenario. Then it would be necessary to conduct a tighter monetary policy and for the repo rate to be raised sooner than is now being forecast.

However, Ms Ekholm also saw some downside risks with regard to developments in the Swedish economy. The economic situation in the Baltic is still difficult, and there is a risk that things will get worse before they get better. The alternative scenario discussed in the draft Monetary Policy Report includes larger loan losses in the Swedish banks leading to a decline in credit granting here in Sweden, which would then have a negative effect on resource utilisation. At the same time, the scenario assumes that the krona will weaken, which will push up inflation. This constitutes a very difficult scenario from a monetary policy point of view. Such a scenario can lead to a conflict of interests for monetary policy, as a deterioration in resource utilisation calls for more expansionary monetary policy, while a depreciation of the krona calls for tighter monetary policy.

With regard to the question of loans at a fixed interest rate with a long maturity, Ms Ekholm said she was in two minds, but that she had decided to recommend a further loan. The situation in the financial markets looks much better now than last spring, and it is not certain that further lending at a fixed interest rate can contribute so much in terms of lower interest rates to households and companies. Moreover, the economic prospects have improved, which means that it is doubtful whether a further fixed-interest rate loan is really necessary to support monetary policy. However, the situation is still not entirely normal and the Swedish banks may face further large loan losses in the Baltic and the Ukraine, which could affect their interest-rate setting and credit granting. Given this, she considered that a further fixed-interest rate loan is justified to ensure that the low-interest rate policy has the intended effect.

Finally, Ms Ekholm wanted to give her view of Mr Svensson's proposal for a cut in the repo rate and a lower repo rate path. Her opinion was that it was at present inappropriate to cut the repo rate further. The repo rate is already at an all-time low, and she pointed out that she supported a further fixed-interest rate loan to contribute further to low interest rates for companies and households. Ms Ekholm felt that a repo rate cut in a situation where households are becoming more optimistic about the future could give effects that were not directly captured by the model simulations presented in the draft Monetary Policy Report.

Cutting the repo rate in this situation could, for instance, have an unhealthy effect on developments in the housing market. Although it is not reasonable that monetary policy is conducted on the basis of how the housing market looks, but on the basis of general developments regarding inflation and resource utilisation, it is nevertheless the case, as pointed out in the draft Report, that house prices have recently increased at a faster rate than expected and that interest rate cuts could be expected to further fuel such a development. It is important to avoid a situation where dramatic adjustments in house prices occur, as this normally has serious consequences for both inflation and resource utilisation.

First Deputy Governor **Svante Öberg** said that he supports the proposal to hold the repo rate unchanged at 0.25 per cent and the repo rate path contained in the main scenario of the draft Monetary Policy Report. He further observed that although GDP growth has been revised upwards, resource utilisation will nevertheless be low throughout the forecast period and that underlying inflation will be in line with the inflation target. This calls for an unchanged low repo rate until autumn 2010.

However, Mr Öberg did not support the proposal to lend a further SEK 100 billion at a fixed interest rate, given the improved situation in the financial markets and the proposed length of the loan. The spreads in several markets have now returned to normal levels. This reduces the reasons for offering fixed-interest rate loans. Moreover, the proposed period for the loan extends so far ahead that it increases the risk of losses for the Riksbank. However, Mr Öberg considered that loans at a variable interest rate could continue to be offered as long as may be necessary.

Mr Öberg stated that he agrees with the assessments and forecasts described in the Monetary Policy Report, but he wishes to comment on the issues of resource utilisation, GDP growth and inflation.

Resource utilisation is very low at present, and will remain low throughout the forecast period. It will take several years before the labour market has recovered from the crisis. According to the forecast, the employment rate will fall up to the year-end 2010/2011 and will not be at a normal level even at the end of the forecast period in 2012. Productivity varies over the economic cycle as a result of variations in the utilisation of labour, also known as labour hoarding. Productivity has now fallen for three years in a row, but according to the forecast it will increase again over the coming years. Despite this, productivity in 2012 will be around 8 per cent below what it would have been if productivity had instead increased by 2.25 per cent a year, calculated from 2006. Part of this gap can probably be explained by lower utilisation of the labour force in companies. Other explanations may be lower capital intensity as a result of reduced investment or lower long-term productivity growth.

The forecasts for GDP growth have now been revised up. It is also possible that growth will be faster than was assumed in the main scenario of the draft Report, as Ms Wickman-Parak and Mr Nyberg claim. But even with higher GDP growth resource utilisation will be low during the forecast period. Mr Öberg found it difficult to believe that even faster GDP growth could push up underlying inflation above the inflation target. On the contrary, his assessment was that there is a risk that inflation will be lower than forecast in the Report. The low resource utilisation will be a factor that holds back inflation over the coming years.

Mr Öberg considered that the upward revisions to the GDP forecasts and the risks of higher growth were not sufficient reason to change the repo rate path decided on at the previous monetary policy meeting.

Mr Öberg considered that as there is a risk that after the crisis resource utilisation and inflation will be low for a long period, the Executive Board may face a difficult situation. The repo rate can not be extremely low for several years. This could have undesirable effects on other areas, the housing market for example. House prices have risen since the beginning of the year. Low interest rates over a long period of time could push up house prices even more. There is a risk that a bubble will build up and eventually burst, which would have negative effects on the economy in the longer term.

Sooner or later the repo rate will therefore need to be raised. In principle it is better to begin raising the interest rate sooner and at a slower rate than later and at a faster rate. But Mr Öberg's assessment was that with the information currently available, an appropriate time to begin raising the repo rate was next autumn.

Governor **Stefan Ingves** pointed out that underlying inflation measured as the CPIF was in line with the target and that the recession had bottomed out in terms of GDP growth, but that the labour market remains weak. According to the forecasts, production will be below the normal level for some time to come. There will be a long period of high unemployment and low resource utilisation. As world trade and the capital stock change, the question arises as to what can be considered a normal level for production and resource utilisation in the future? This is a question that a number of other countries are also struggling with at present.

Mr Ingves considered that the prevailing economic climate all in all called for a continuation of the expansionary monetary policy conducted in Sweden and he therefore supported the Report's proposal for an unchanged repo rate and a repo rate path at the current interest rate up to autumn 2010. He pointed out that growth in Europe is expected to be low. Unit labour costs are low, inflation is close to the target and as it will take a further two years before GDP attains the same level as in 2008, monetary policy needs to support the general development of the economy. An IMF study draws the conclusion that active monetary policy and fiscal policy reduces the loss in production that arises in a financial crisis. Countries with a current account surplus have greater scope to take measures. For Sweden the current situation is different from the 1990s, as this crisis was not generated here. This time an extra concern has arisen, as we must manage the external effects of a global financial crisis, which for Sweden means falling exports and the financial uncertainty arising from developments in the Baltic countries. But on the other hand, this time, unlike the 1990s, we have greater opportunity to make use of both monetary policy and fiscal policy as we went into the crisis with a surplus on both the current account and public finances. We therefore have better scope than many other countries to manage the situation that has arisen, and we shall do so.

Mr Ingves also supported the proposal for continued fixed-interest rate loans. He considered that, in addition to the support to monetary policy, good access to liquidity facilitates the recovery in the financial markets. Mr Ingves also agreed with Ms Ekholm that the situation in the Baltic countries was still a risk factor.

He went on to observe that the volume of the lending guaranteed by the Swedish National Debt Office has stabilised and the Riksbank's loans in US dollars are being phased out, while lending at a variable interest rate has fallen. Altogether, this indicates that the situation has changed, so that one can move from a situation with maximum focus on financial stability towards a controlled recovery but with insurance against setbacks.

At the same time, the situation is not yet normal with regard to different types of extraordinary measures or in Sweden's neighbouring area, particularly the Baltic countries. Given this, it is appropriate to support traditional monetary policy on this occasion, too, with further lending. This will strengthen the impact of monetary policy at a time when we are not yet on stable ground.

Mr Ingves also pointed out that monetary policy is meant to influence and steer the general level of demand in the economy. The discussion on the housing market concerns the future and potential problems in this area perhaps affect the period beyond the forecast horizon. The repo rate path illustrates the fact that monetary policy will return to a more normal level of around 4 per cent. The important thing is that we are aware of this now. He pointed out that monetary policy cannot manage all of the problems that may arise in the housing market; financial supervision and economic policy also have a role to play. The Riksbank, Finansinspektionen (the Swedish Financial Supervisory Authority) and the Ministry of Finance therefore need to cooperate on this issue.

Mr Ingves commented in conclusion Mr Svensson's proposal to cut the repo rate to zero and said that this had been discussed before, partly on the basis of what can be considered a reasonable lower bound for the repo rate in monetary policy terms, and partly on the basis of the effects on the functioning of the financial markets. He considered that 0.25 per cent was a reasonable lower bound and that there is no reason to take up the issue again, as the fixed-interest rate loan provides the same effects.

Deputy Governor **Lars Nyberg** stated that he agreed to a large extent with the analysis presented in the draft Monetary Policy Report with regard to developments in Sweden. However, he believed, as with regard to international developments, that the strength of the economic upturn had been slightly underestimated, in particular with regard to export and consumption.

Nor did he share all of the conclusions in the analysis. Mr Nyberg agreed that inflation did not comprise any problem at present, and that the repo rate needs to be held at a low level (0.25 per cent) over a long period of time to counteract the uniquely low capacity utilisation in the economy. However, he said at the previous meeting that the upward revision to the growth forecast prior to that meeting could have justified a slightly earlier increase in the repo rate than that forecast in the main scenario. Now the forecast for growth has been revised up further, but without this having any effect on the repo rate path in the main scenario. The repo rate path is thus the same as in July, despite the fact that growth has been revised upwards on two occasions since then, both for this year and for next year. Mr Nyberg considered back in September that the repo rate might need to be raised slightly sooner than in the main scenario; at the end of the spring or beginning of the summer of 2010, rather than in the autumn. He considered that economic developments supported this conclusion, now even more than at the previous meeting.

Mr Nyberg also wished to comment on a couple of the downside risks regarding future developments. The fragility of the financial recovery has been highlighted in various contexts, and of course it is still possible to experience setbacks here. But Mr Nyberg considered the probability of this to be less for every month that passes. Developments in parts of the Baltic have been put forward as a problem, and the probability of unpleasant surprises there is no less than before. But the probable negative effects for Sweden are much less than they were six months ago, partly because the situation in the financial markets as a whole looks much better, and partly because the Swedish banks involved have strengthened their capital bases substantially. It is difficult to see that developments in the Baltic today could comprise a substantial risk to the economic recovery in Sweden.

With regard to further lending to the banks of SEK 100 billion, Mr Nyberg considered this to be both unnecessary and unfortunate. Unnecessary because the economy does not need further stimulation at present. The uniquely low repo rate in a domestic and international comparison and the Executive Board's clearly expressed ambition to keep it low over a long period of time are quite sufficient stimulation. Unfortunate because the bank system does not need more liquidity in a time when other countries with much greater problems than Sweden have begun phasing out their measures. Mr Nyberg did not consider reference to the uncertainty in the Baltic countries to be a sufficiently convincing reason. If something unforeseen were to happen, the Riksbank could contribute liquidity on that occasion, just as it did last autumn.

Perhaps lending will, as before, have a marginal effect on interest rate-setting in the short term, but he considered it an open question as to how this would affect the credibility of the repo rate path in the slightly longer term. Previously it has been said that the lending should contribute to making the low repo rate path credible. But next year, SEK 300 billion kronor in liquidity will be withdrawn from the bank system during a relatively short period of time. Merely the knowledge that this is about to happen should put upward pressure on interest rates long before the loans mature.

Finally, Mr Nyberg wished to say a few words about the housing market. Despite falling GDP and rising unemployment, the rate of increase in the banks' lending to households has begun to rise once again and house prices have swung upwards. This is an unexpected development, as was pointed out in an article in the draft Monetary Policy Report, given what is happening in the real economy, and it can reasonably be said to be connected to the fact that it is cheap to borrow as interest rates are low. Rising stock market rates and steadily-growing consumer confidence probably also play a role.

As he sees it, this is not a problem in the short term. But it could become a problem in the slightly longer term, perhaps beyond the forecast horizon of the Report. It is therefore important to closely follow developments. Interest rates will not be low for ever, which is clear from the repo rate path. On the contrary, fairly rapid and substantial interest rate increases will come when the economic downturn comes to an end. There is reason for both banks and households to leave a good margin for this in their calculations.

In this context he noted that the British Financial Services Authority, FSA, had recently introduced clear incentives for the banks to limit their lending to households. Increased requirements for amortisation and lower loan limits could also be used in Sweden if developments appear to be taking the wrong direction. Such measures, which are very

effective with regard to limiting household lending, come primarily under the authority of Finansinspektionen. But the Riksbank will make it clear that we think lending is increasing too rapidly. However, he did not consider that raising the interest rate sooner than can be justified for other reasons, as the Riksbank has done in other contexts, is an alternative at present. At the moment, a low repo rate is needed and it will be needed for a relatively long period of time.

Deputy Governor **Barbro Wickman-Parak** pointed out that the forecast for GDP growth in Sweden for the second half of this year has been revised upwards, but that the growth sequence for next year remains largely the same as in September.

She repeated that she has a slightly more positive view of international developments, but than even with the international forecast contained in the main scenario her assessment was that the forecast for exports was too cautious. In the main scenario market growth for Swedish exports is expected to increase by 5.7 per cent next year. This is an upward revision of 2.5 percentage points compared with September. At the same time, the forecast for exports has been revised upwards by only half a percentage point. Monthly statistics are already pointing to exports having recovered and export orders according to Statistics Sweden's figures point to a continuing recovery. The National Institute of Economic Research's indicator for export orders has risen steadily since the summer and the same sub-indicator in the purchasing managers' index has risen rapidly and resolutely since the start of the year. Her assessment was that exports would be stronger next year than is forecast in the main scenario of the Report.

She pointed out that in September her assessment was that the forecast for private consumption was overly cautious. Now the downturn this year would be lower than the previous forecast, partly because the outcome in the second quarter was slightly stronger than in the preliminary figures for the National Accounts, and partly because the forecast for the second half of the year has been adjusted upwards slightly. But for next year the growth profile is the same as before. Her assessment was that private consumption could be stronger than in the main scenario, and she did not want to repeat her arguments here, but referred back to what she said in September.

She also pointed out that employment would continue falling next year, according to the forecast, but that the fall is expected to be slightly smaller in both 2010 and 2011 than was forecast in September. This is a revision in the right direction and she would not be surprised if the same type of revision is made to coming forecasts.

Ms Wickman-Parak wanted to take the opportunity to comment on making forecasts under the shadow of a financial crisis and on the way developments are described. Comparisons are often made with other financial crises, and with regard to Sweden the obvious comparison is with our own domestically-generated crisis in the 1990s. She referred to Figure 1:15 in the Report, which shows how the Swedish economy has recovered following various recessions. With the current main scenario it will take around 14 quarters before GDP once again reaches the level prevailing before the recession. This is a long time, but slightly more quickly than after the 1990s crisis. It appears to be some sort of accepted truth that this is the way things will be following financial crises.

She thought that it is of course a good thing to analyse history and learn lessons from previous experiences. But at the same time it is all too easy to make exaggerated

comparisons. The current crisis originated outside of Sweden and we were hit hard by an exceptionally large fall in demand from abroad. In the 1990s the fall in growth did not come as abruptly and quickly, but we had three years of an accelerating fall. During the course of the crisis we had to face the acid test of the consolidation of public sector finances. This time fiscal policy has instead had a stimulating effect.

When the crisis occurred last time, households' finances were weak; unlike now, they had no large savings to start with. On the contrary, the saving ratio had been negative for several years. There are also other major differences in the way households have been affected. We are now experiencing a large fall in employment in Sweden; according to the main scenario the number of employed will fall by 180,000 people between 2008 and 2012. These are large figures and neither monetary policy nor economic policy as a whole has been able to prevent this from happening. But it hardly compares to the 1990s crisis, when employment fell several years and by almost 600,000 from the peak to the trough. During the previous crisis, households also saw the burden of accumulated debt become much heavier when the tax system was changed and they were then affected by sharply rising real interest rates after tax. Then, we also saw house prices falling by around 30 per cent from the peak to the trough. This can hardly be compared with what we are seeing now.

She therefore wanted to emphasise that Sweden's own conditions for a recovery now are much more favourable than they were last time. Of course developments in Sweden may be more negative than the main scenario indicates, but the major risk for problems lies abroad, as she saw it, that there might be considerable setbacks in international economic activity.

Ms Wickman-Parak supported the proposal to hold the repo rate unchanged at 0.25 per cent. This is on the basis of the currently depressed resource utilisation and an inflation rate that does not appear to offer any problems at present. But she pointed out that the real economy is recovering; a normalisation is occurring after a crisis that has taken place very rapidly and been very deep. She considered that later on in this process it will be necessary for the interest rate to move away from its current crisis time level. Her assessment now, as before, was that the repo rate may need to be raised in the late spring or summer. She therefore entered a reservation against the repo rate path.

She stated that she, as she had mentioned in the minutes in September, sees a value in ensuring that the process of normalising interest rates occurs gradually to give households and companies better opportunity to adjust to a situation with higher interest rates. She also wanted to repeat that over the course of time one should be aware of the imbalances that can build up when the interest rate is held at a low level over a long period of time.

Finally, she stated that she did not support the proposal to offer a fixed-interest rate loan to the banks. She said that the Riksbank is now conducting a very expansionary monetary policy and as she sees it there are good reasons to wait and see before adding further fixed-interest loans. The possibility to take such measures is always there if the economic recovery were to falter.

Deputy Governor **Lars E.O. Svensson** wanted to comment on a few of the things that had been said and to examine the arguments for and against the lower repo rate path that he advocates. He said that even if one believes in a better development of the real economy than is forecast in the main scenario of the Report, resource utilisation is still low. There

cannot be said to be any risk that the economy will improve so quickly that there is a risk it will become overheated. If one is to consider which repo-rate path is best if the economy develops better, then one should compare 2-3 different repo rate paths and compare outcomes for inflation and resource utilisation in the different cases. This is not done in the Report, but if one was to make such an analysis according to the method presented at the end of Chapter 2 of the Report, one would see that a lower repo rate path would also be better in this case.

Mr Svensson also observed that other forecasters systematically have lower forecasts for inflation and also lower forecasts for resource utilisation than the Riksbank has, so the Riksbank's main scenario is already optimistic in comparison with the forecasts of other forecasters.

Another counter-argument against a lower repo rate path is the developments in house prices. Mr Svensson said that there were no signs of a house price bubble in Sweden at present. If this were to happen it would be a problem for the future. He did not believe that a repo rate 25 basis points lower would play any role in developments in house prices. He had been given the opportunity to reflect further on asset prices and monetary policy in connection with a speech he held in Amsterdam at the end of September on these issues. He pointed out then that asset prices should not be a target for monetary policy and that asset prices should only be taken into account to the extent that they might be expected to affect inflation and resource utilisation. House prices can be an important part of financial stability, but potential problems can be better dealt with by other means, as Mr Nyberg has already pointed out, for example limiting the debt-to-value ratio, requiring correct information and realistic housing cost calculations for house buyers and so forth. And as Mr Ingves emphasised, the repo rate path shows that the repo rate will eventually return to a normal level which should be taken into account when calculating housing costs. The repo rate is a blunt instrument with moderate effects on house prices. When weighing up alternative repo-rate paths against each other, one must take into account the effects on resource utilisation and inflation. Even if one were to believe that house prices may become a problem, this problem should be weighed against the possibility to save 10,000 to 25,000 jobs and the gains this would entail.

Mr Svensson also wanted to comment on Mr Ingves' suggestion that a lower repo rate could affect the functioning of the financial markets. In this context one might wonder whether any new information has been received? There is now a detailed economic commentary about this written by Meredith Beechey and Heidi Elmér, published on the Riksbank's website. It contains a review of all the potential problems. There are no indications that a repo rate of 0.25 per cent would have caused the financial markets any problems at all. Now we also have a few months' more experience of a very low repo rate and as several members of the Executive Board have already pointed out, the financial markets are beginning to normalise. SEB's and Swedbank's reports show a robust net interest income that would also cope with a cut in the repo rate to zero. Mr Svensson pointed out again that the potential problems in the financial markets must be weighed against the jobs that can be saved. He did not find the arguments against a lower repo rate path convincing.

First Deputy Governor **Svante Öberg** wished to add two comments. Firstly, he considered that the discussion today exaggerates the division among Executive Board members. He

would instead prefer to focus on the unity - that everyone considers a low repo rate to be needed for a long time to come. Then there are differences in nuance, where Mr Svensson would prefer a slightly lower repo rate, while Ms Wickman-Parak and Mr Nyberg consider the repo rate should be raised slightly sooner than forecast. However, there is a greater division regarding the suitability of further fixed-interest rate loans.

Secondly, GDP developments after the crisis require further analysis. The general pattern in connection with economic downturns is that GDP increases more slowly than the trend in the economic downturn and more quickly than the trend in the coming upturn. This also applies to larger financial crises. In the draft Report one is also assuming that GDP growth in Sweden over the coming three years will be higher than the trend. One difference after financial crises is that the upturn is slower and more prolonged than following other economic downturns. There should also be further analysis of what is meant by a "normal GDP level" after the crisis. How much does the "normal GDP level" decline in relation to the trend as a result of the crisis?

Deputy Governor **Lars E.O. Svensson** agreed with Mr Öberg that resource utilisation, its normal level and potential production should be examined further.

Governor **Stefan Ingves** agreed with Mr Öberg that the Executive Board was actually fairly unanimous; it was not a question of fundamentally different directions for monetary policy, but rather differences in degree. This in turn was perhaps not so surprising given the unusual period we are in.

Mr Ingves also wished to comment on Ms Wickman-Parak's comparison with the crisis in the 1990s. He agreed that we in Sweden now have a much greater degree of freedom than we had then, but that we must still remember that other countries are in a much worse condition now. One therefore cannot expect the sequence of events to be identical for these two crises; one must act on the basis of an overall assessment, where different members of the Executive Board have slightly different views.

Mr Ingves also wished to emphasise that his earlier comment on house prices referred to the future and he referred to the article on this in the draft Report. Further, he pointed out that one must remember that some of the measures taken by the Riksbank were phasing themselves out. The demand for loans at a variable interest rate, for example, appeared to have ground to a halt and thus a further fixed-interest rate loan would mean retaining the same net total.

Deputy Governor **Lars Nyberg** agreed with Mr Öberg that the entire Executive Board agreed that the repo rate path should be low over a long period of time. He also noted that it was easy to agree with Mr Svensson that 10,000 jobs should be saved, but he felt that this reasoning was based on a belief in the forecast in the Report and the models used to calculate this figure. He did not believe that these models fully take into account the situation in the financial markets.

Deputy Governor **Barbro Wickman-Parak** said that Mr Svensson's reasoning is interesting, but that it does not apply if one does not agree with the forecast in the Report. She noted that in the figure for the mean square gap in Chapter 2 there was no set point that would correspond to her assessment. She said that Mr Svensson should be prepared to explain how he had arrived at the figure of 10,000 to 25,000 jobs.

Deputy Governor **Lars E.O. Svensson** pointed out that his general stance in this situation in favour of a lower repo-rate path was not based on any specific model calculation, but rather based on the general insight that a lower repo-rate path stimulates the economy more. The specific calculation of the number of jobs saved was based on Table A12 in the draft monetary policy report. This concerns the effect on employment of an expected repo rate path that is 25 basis points lower for one year than the main scenario. In Table A12 the labour market gap for 2010 falls to -1.9 per cent with a lower repo rate path, instead of to -2.1 per cent, that is a difference of 0.2 percentage points. This corresponds to 10,000 jobs saved. However, the calculation in Table A 12 is for technical reasons made under the assumption that the lower repo rate on each occasion a decision is made over the coming year is a surprise. If the lower repo rate path were published now instead and was expected in the future, the effect on employment would be even greater. Depending on which precise assumptions one makes, his assessment is that the number of jobs saved in 2010 may be in the interval 10,000 to 25,000.

Governor **Stefan Ingves** then summarised the monetary policy discussion. The situation in the financial markets has continued to deteriorate, while companies and households are more optimistic about the future. The recovery has begun and GDP growth in the world economy looks to be slightly stronger than expected. However, it has a fragile base and future developments are still uncertain. Sweden has been hit hard by the deep recession abroad and the recovery will take time.

The repo rate needs to be low over a long period of time to come to enable a stable development on the economy and to attain the inflation target of 2 per cent. The repo rate should therefore be held unchanged at 0.25 per cent and the interest rate is expected to remain at this level until autumn 2010. The forecast for the repo rate is the same as in September.

Although the situation in the financial markets has improved, it is still not normal. Supplementary measures are therefore necessary to ensure that monetary policy has the intended effect. The Riksbank should therefore offer further loans totalling SEK 100 billion to the banks at a fixed interest rate and with a maturity of 11 months. This should contribute to continued lower interest rates on loans to companies and households.

The low interest rate, together with increased demand from abroad, will contribute to stronger GDP growth in Sweden in the future. The labour market lags behind GDP growth and employment is not expected to begin to rise until the beginning of 2011. Wages are therefore expected to increase at a slow rate.

As economic activity recovers, the repo rate will be raised to more normal levels to attain a balanced development of the economy and an inflation rate in line with the target. Changes in the repo rate affect mortgage rates, which are included in the consumer price index (CPI). There will thus be large fluctuations in the CPI in the future. The CPIF underlying inflation rate (the CPI with a fixed mortgage rate) will on the other hand remain stable close to 2 per cent during the forecast period.

There is still considerable uncertainty surrounding future developments. It is possible that the international recovery will be quicker than is expected in the main scenario, as a result of the improved situation in the financial markets. However, it is also possible that the recovery could slow down when the fiscal policy stimulation packages around the world are phased

out. The future direction for monetary policy will depend, as always, on how economic developments abroad and in Sweden will affect the prospects for inflation and economic activity in Sweden.

§ 4. Monetary policy decision

The Chairman observed that there was a proposal to hold the repo rate unchanged at 0.25 per cent and a proposal to cut the repo rate by 0.25 percentage points.

The Executive Board decided after voting

- to adopt the Monetary Policy Report according to the proposal, Annex A to the minutes,
- to publish the Monetary Policy Report on Thursday 22 October at 09.30 a.m.,
- to hold the repo rate unchanged at 0.25 per cent and that this decision would apply from and including 28 October 2009,
- to hold the lending rate unchanged at 0.75 per cent, and the deposit rate unchanged at -0.25 per cent, with effect from and including 28 October 2009,
- to announce the decision at 9.30 a.m. on Thursday 22 October 2009 with the motivation and wording contained in Press Release no. 91 2009 (Annex B to the minutes), and
- to publish the minutes of today's meeting on Wednesday, 4 November at 9.30 a.m.

Deputy Governor Lars E.O. Svensson entered a reservation against the decision and advocated cutting the repo rate to 0 per cent and a repo rate path that meant the repo rate would be kept at this level until the end of the third quarter of 2010. According to Mr Svensson such a repo rate path entails a better-balanced monetary policy, with lower unemployment, higher resource utilisation and a CPIF inflation rate closer to the target, without causing any problems to the functioning of the financial markets or to financial stability.

Deputy Governors Lars Nyberg and Barbro Wickman-Parak supported the decision to hold the repo rate unchanged at 0.25 per cent, but entered reservations against the growth forecasts in the Monetary Policy Report and thereby the repo rate path. They motivated their stance by stating, for instance, a more positive view of how developments in the financial markets could affect economic activity both in Sweden and abroad. This would mean that the interest rate needed to be raised slightly earlier than is forecast in the Monetary Policy Report. Nor did they consider that the economy needed to be stimulated by further loans to the banks at a fixed interest rate, see separate minutes no. 16.

It is also noted in these minutes that First Deputy Governor Svante Öberg entered a reservation against a further fixed-interest rate loan, given the improved situation in the financial markets and the time to maturity of the loan, but he supported the decision to hold the repo rate and the repo rate path unchanged, see separate minutes no. 16.

This paragraph was confirmed immediately.

Minutes by

Ann-Christine Högberg

Checked by:

Karolina Ekholm

Stefan Ingves

Lars Nyberg

Lars E.O. Svensson

Barbro Wickman-Parak

Svante Öberg