Minutes of the Executive Board's monetary policy meeting, no. 2

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 787 00 00
Fax +46 8 21 05 31
registratorn@riksbank.se
www.riksbank.se

DATE: 17 April 2012

TIME: 9.00

PRESENT:

Stefan Ingves, Chairman
Karolina Ekholm
Per Jansson
Kerstin af Jochnick
Barbro Wickman-Parak
Lars E.O. Svensson

Sigvard Ahlzén (§ 1)
Charlotta Edler
Heidi Elmér
Johannes Forss Sandahl (§ 1)
Ann-Christine Högberg
Jesper Johansson
Pernilla Johansson
Tomas Lundberg (§ 2-4)
Pernilla Meyersson
Marianne Nessén
Christina Nyman
Mattias Persson (§ 1)
Bengt Pettersson
Ulf Söderström
Lena Strömberg (§1)
Åsa Sydén
David Vestin
Staffan Viotti
Hanna Öberg (§ 1)

It was noted that Pernilla Johansson and Bengt Pettersson would prepare draft minutes of § 1, 2 and 3 of the Executive Board's monetary policy meeting.

§1. Economic developments

Johan Forss Sandahl of the Financial Stability Department began by presenting recent developments regarding financial stability with a focus on the situation regarding public finances in Europe. The Eurogroup has reached an agreement on a firewall to manage the sovereign debt situation. The expectations on the financial markets were that the firewall would be slightly larger than was actually agreed by the Eurogroup. Furthermore, Spanish and Italian government bond yields have recently begun to rise because market participants feel uncertainty regarding these countries' debt-servicing ability. Statistics from the European Central Bank (ECB) and national central banks show that both Spanish and Italian banks were among those that increased their borrowing from the ECB the most during the ECB's most recent offers of loans in euro with a three-year maturity. These banks have also increased their holdings of government bonds in January and February. Although the ECB's loans have contributed to greater liquidity, there is still a need for increased equity capital among several banks in the euro area. Risk aversion has increased generally abroad, and so-called credit default swap (CDS) premiums on banks have recently risen in both the United States and Europe.

Hanna Öberg of the Monetary Policy Department then reported on developments on the financial markets. In recent weeks share prices have fallen both in Sweden and abroad. This has taken place in the light of new international statistics, such as the purchasing managers' index in Europe being poorer than the market was expecting and the increase in US employment in March being less than the market had expected. The sovereign debt problems in Spain have also contributed to a generally poorer development in the financial markets. The above-mentioned factors have contributed to a weakening in the TCW-weighted krona exchange rate in relation to February. Monetary policy expectations in Sweden, as expressed in forward pricing, have risen somewhat since February when it comes to developments towards the end of 2012 and onwards. Strong outcomes in the National Institute of Economic Research's Economic Tendency Survey and the Swedish retail trade statistics have contributed to the upturn. Market pricing currently implies an 80-per cent probability of a repo-rate cut at the monetary policy meeting. However, most bank economists believe the repo rate will be held unchanged. Similarly, most survey respondents expect the repo rate to be held unchanged at the monetary policy meeting.

Christina Nyman, Deputy Head of the Monetary Policy Department, presented the draft Monetary Policy Update which, in the assessment of the Monetary Policy Department, should gain the support of the majority of the Executive Board members. She began by noting that the forecasts in the draft Update were discussed by the Executive Board at meetings held on 20 and 28 March and on 2 April. The text of the Monetary Policy Update was tabled at a meeting of the Executive Board on 13 April.

Since the February Monetary Policy Report was published, developments in the world economy as a whole have been relatively good. There are, however, major differences between different regions and countries. Growth conditions for the euro area are still weak, as a result of the sovereign debt crisis. The forecast is that the debt crisis will be managed in the coming period and that the acute phase of the crisis will abate this year, but that the road to recovery will not be entirely smooth and there will probably be setbacks. It will probably be a case of two steps forwards and one step backwards. In the

United States, growth prospects look better and the labour market is continuing to improve. The GDP forecast for the United States has been revised up for 2012. Developments in the world economy will be subdued by the rise in the oil price of around 10 dollars a barrel, compared with February, and expectations as expressed in forward pricing have been adjusted upwards by on average 8 dollars during the forecast period. This has contributed to the forecast for inflation abroad in terms of the TCW being revised upwards and to the forecast for GDP being revised downwards somewhat. The forecast for global GDP growth is around 4 per cent a year for the coming years, as a result of favourable developments in the emerging markets. International policy rates are expected to remain low during the forecast period.

In Sweden there was an unexpectedly large fall in GDP in the fourth quarter of last year, primarily due to a rapid fall in exports. Statistics received since then imply some stabilisation, however; there are some positive signs in the Swedish economy. Exports of goods are increasing again, retail trade figures are rising, the purchasing managers' index has increased somewhat at the beginning of the year and the National Institute of Economic Research's Economic Tendency Survey rose substantially in March. At the same time, inflation is low. CPI inflation was 1.5 per cent in March and CPIF inflation, which excludes the direct effects of changes in mortgage rates, was 1.1 per cent. This is in line with the assessment made in February. An unemployment figure of 7.5 per cent in February is also in line with the forecast made then.

At the same time as the outcome for GDP in the fourth quarter was published, revised National Accounts figures were published. The number of hours worked had been revised up from 2010 and onwards, which means that productivity growth had been revised down. These revisions have been a question that was discussed by the monetary policy drafting group and they have been interpreted as showing that the productivity growth trend has also been weaker than was earlier assessed, and that resource utilisation in the labour market, in terms of the number of hours worked, has been slightly higher. Another related issue that was discussed is how this will affect cost pressures in the coming period.

In the forecast for Sweden, GDP is expected to increase again in the first quarter of this year, and growth is expected to accelerate in 2013. The forecast has been revised up for the first quarters of this year, but for the year 2012 as whole, growth is only 0.4 per cent, given the very weak developments towards the end of 2011. The forecast for GDP growth for 2013 and 2014 has been revised down somewhat, partly as a result of the assumption that the productivity growth trend is lower. The labour market is expected to deteriorate this year, at the same time as inflation remains low. Cost pressures will gradually increase, with higher wage increases and more subdued productivity growth. Inflation is therefore expected to rise during 2013 and amount to around 2 per cent, when measured in terms of the CPIF, for the remainder of the forecast period. The forecasts for inflation and unemployment are thus only marginally revised. The forecast for the repo rate is that it will be held unchanged at 1.5 per cent at today's monetary policy meeting and remain at this level for around one year, and then rise towards 3 per cent at the end of the forecast period, the first quarter of 2015. If confidence among households and companies returns more quickly than anticipated, there may be reason to revise up this forecast. However, if the problems in the euro area worsen, there may be reason to revise the forecast down.

§2. Economic outlook abroad

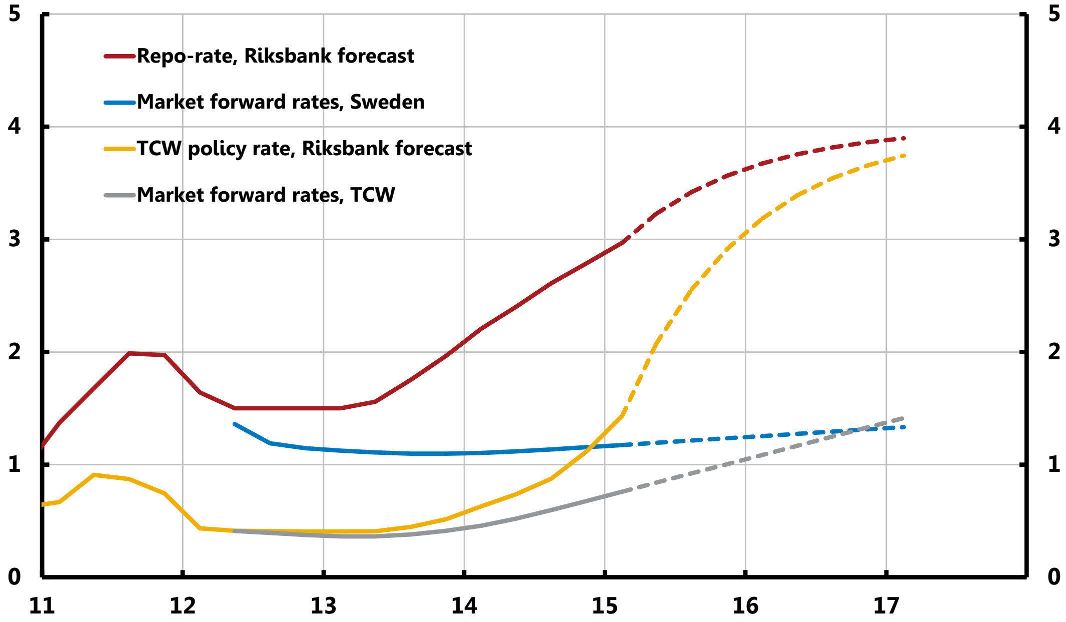
Deputy Governor **Lars E.O. Svensson** began by saying that he considered the view of growth prospects for the euro area described in the draft Monetary Policy Update to be too optimistic. The GDP growth forecast for 2012 is almost the same as the International Monetary Fund's (IMF) forecast, but for 2013 it is a few tenths higher. The GDP growth forecast is also much higher than Norges Bank's forecast for the euro area made in March 2012 for the coming years.

Mr Svensson did not consider that any good reasons had been given for the more optimistic forecast for the euro area in the Monetary Policy Update in relation to other forecasters. Moreover, the Riksbank's forecasts endeavour to be mean forecasts, that is, unbiased forecasts that incorporate the upside and downside risks. The IMF's forecast must be regarded as a mode forecast, where downside risks dominate. This means that the corresponding mean forecast is lower, said Mr Svensson. Determining how much lower requires an assessment of the uncertainty and of how asymmetric the risk distribution is. This could result in a lower forecast by several tenths. Compared with such mean forecasts, the Riksbank's forecast appears even more optimistic. A downward adjustment of the growth forecast for the euro area should also reasonably entail a downward adjustment of the inflation and policy rate forecasts for the euro area.

Mr Svensson also maintained, as at earlier monetary policy meetings, that the forecast for policy rates abroad in the Monetary Policy Update was too high. The solid yellow line in Figure 1 shows the forecast for TCW-weighted policy rates abroad in the Monetary Policy Update. The dashed yellow line beyond the 3-year horizon shows the technical assumption used in the Ramses model on how the policy rates abroad will develop beyond the forecast horizon. The grey line shows TCW-weighted implied forward rates, adjusted for normal forward premiums, that is, by one basis point per month. The grey dashed line beyond the 3-year horizon indicates a more uncertain estimate. Further ahead, the forecast is much higher than the forward rates and this will contribute, all else being equal, to a much higher repo-rate path. As far as Mr Svensson knew, the Riksbank is unique among central banks in making such high forecasts for policy rates abroad, and as at earlier monetary policy meetings he could see no good reason for this.

Figure 1. Repo-rate path, forward rates and forecast for TCW-weighted policy rate, April 2012

Per cent. Forward rates from 12 April



Note: The implied forward rates are adjusted for credit risk and maturity premiums using a rule of thumb of 1 basis point per month. The curves are extrapolated for the quarters beyond the forecast horizon (2015, Q1) and not based on actual market pricing.

Sources: National sources, Reuters EcoWin, the Riksbank and own calculations

Deputy Governor **Barbro Wickman-Parak** said that the picture of international economic activity expressed in the forecast in the February Monetary Policy Report still essentially applied. The key issue is whether the weak GDP fall predicted in the forecast for the euro area this year is as far as it goes, and whether the modest growth expected afterwards will be realised. This in turn is linked to confidence on the financial markets and any repercussions on this from confidence among households and companies.

At the previous monetary policy meeting it was noted that there had been some stabilisation on the financial markets. Not least important was that interest rates for large debt-ridden countries such as Italy and Spain had fallen from high levels during the autumn. In recent weeks the tension on the financial markets has increase again, with a particular focus on Spain. Yields on Spanish government bonds have risen once again and Italy has followed some of the way, although bond yields have not returned to the high levels of last autumn.

Ms Wickman-Parak said that everyone agreed that Europe is struggling with serious problems, but that confidence in the ability to resolve them varies, not just between analysts but also over time. Even in more normal situations there are often fluctuations on the financial markets. In a sensitive situation such as the present, one must expect this phenomenon to be more pronounced.

Although the main scenario in the Monetary Policy Update predicts a stabilisation of the financial markets in the slightly longer run, the path there is not entirely straight and even. Concerns over the Spanish banking system and the compromises over the country's budget deficit target have had a negative effect on confidence. But at the same time there are factors that should have a counteracting effect. During the autumn there was an impending threat of a Greek payment default. There were expectations that Ireland, but above all Portugal might suffer similar problems and that an escalated crisis in Spain and Italy would ensue. Now the write-down of the Greek public debt has been completed without market turbulence and another support package has been implemented. This does not resolve the long-term problems, but should create some breathing space for Greece, and also for other crisis countries which hopefully have the capacity to make use of it.

The fact that the euro area countries have agreed to increase the capacity of their support funds, particularly in the short run, should also be regarded as a step in the right directions, according to Ms Wickman-Parak. Even if there is some criticism that this is not "new" money. An increase in the euro area countries' own financial safety net is necessary for a decision on an increase in the IMF's resource to be achieved. A potential decision could be made at the IMF's spring meeting or in the early summer. The build-up of these firewalls is important for financial stability.

There is often impatience on the financial markets for the slowness of the political processes. But the various steps that are gradually taken at a political level should be able to provide stability in a confidence crisis that is largely political, according to Ms Wickman-Parak.

There is every reason to express caution with regard to future developments. One must unfortunately expect sudden and dramatic changes on the financial markets and that various statistical outcomes may cause waves of disappointment. But Ms Wickman-Parak nevertheless believed that the assumption in the Monetary Policy Update regarding increased confidence in the slightly longer run is reasonable, although the threat of a worse crisis remains. She said that for her part, the fact that the US economy has continued to move in the right direction made the forecast for growth in the global economy more credible.

Deputy Governor **Karolina Ekholm** began by saying that she agreed with Ms Wickman-Parak that, regardless of developments slightly further ahead, one must assume that the global economy may face the occasional setback in the coming period. The most important point for assessing longer-run prospects is that there are substantial structural problems in the global economy – both within certain countries and in the relationships between countries.

The United States is facing a need for increased aggregate saving and a shift in production where the importance of domestic demand declines at the same time as exports become a greater driving force. Europe is facing the need for budget consolidation in many countries, and reduced regional imbalances, with the countries in southern Europe needing to increase their competitiveness. China is also facing structural challenges with regard to reducing its dependence on the export sector for growth. This involves major problems of adjustment that it will take a long time to implement, even in a rose-coloured scenario.

However, Ms Ekholm emphasised that with regard to the medium-term forecast the Riksbank is presenting now and the decision the Executive Board has to take today, the important issues are how growth, inflation, interest and exchange rates abroad can be expected to develop over the coming years. This is not so easy to assess. What is obvious, however, is that the need for fiscal policy tightening will hamper growth in Europe and the United States, and that this will lead to a relatively expansionary monetary policy to compensate. But then of course the adjustment that needs to be made in the long term may be affected in the long time by both periods of strong optimism and rising stock markets and periods of strong pessimism and financial market turbulence.

Ms Ekholm felt that the forecast for developments abroad presented in the draft Monetary Policy Update was largely a reasonable one that she could support. Like Mr Svensson, she felt that it appeared too positive with regard to growth prospects for the euro area further ahead in the forecast, given the substantial need for budget consolidation in some countries. However, she supported the basic starting point that the euro crisis would not escalate to any great degree.

Ms Ekholm said that one reason for her repeated criticism of the forecast for developments abroad has been the forecast for policy rates. On the previous occasion the difference between the TCW path in the forecast and implied forward rates was fairly small and only arose towards the end of the forecast horizon. This time, the difference appears to be even smaller, and is so slight that it perhaps need not play any major role for the forecast as a whole.

However, Ms Ekholm felt that it nevertheless played a fairly major role in the model simulations, where one compares what a forecast that entirely follows forward rates would mean for the Swedish economy. This is because the expected interest rate spreads towards Sweden that arise beyond the forecast horizon have a very large impact in the Ramses model on inflation and resource utilisation today, particularly via the exchange rate. As Mr Svensson showed in his figure (Figure 1), the TCW path implemented in the Ramses model rises very quickly after the forecast period. A path that is completely based on implied forward rates will give rise, depending on how it is implemented after the end of the forecast period, to greater or smaller interest rate differences in relation to the Swedish policy rate, and this then has considerable significance for how the model forecast for the Swedish economy will look. Ms Ekholm was sceptical towards differences in the forecast policy rates abroad of around a half a percentage point in three years' time having such a large significance for the model forecast for Sweden. But, given that this is how things are and that as far as she could see there were no particularly strong reasons to believe that an unbiased forecast for the TCW rate in three years' time would be half a percentage point higher than was implied by market pricing, she considered it would be better in this situation to adopt the path based on the forward rates. However, she felt that it was perhaps a little excessive to enter a reservation against a difference of one half of a percentage point in three years' time. She satisfied herself with pointing out that she believes that the way in which the TCW path is implemented in the Riksbank's forecasting model, Ramses, entails an unrealistically rapid rise in the TCW path towards a long-run equilibrium level and that this can affect the model forecast and thereby to some extent the assessment of what is considered an appropriate repo-rate path for Sweden.

First Deputy Governor **Kerstin af Jochnick** noted to begin with that she shared the view of international developments described in the draft Monetary Policy Update. Developments abroad have largely followed the path forecast in the February Monetary Policy Report, but on the other hand measures in Europe have reduced the risk of a poorer outcome in the euro area.

Ms af Jochnick's assessment was that growth in the world economy is relatively good, but that growth in countries that are significant to Swedish exports will be weak over the coming year. Growth prospects for the United States have improved, which is reflected in the increased activity among companies and households. Growth in China will probably be somewhat subdued, but remain good. However, her assessment was that developments in Europe will be very weak over the coming years. There are exceptions, such as Germany, but the tight fiscal policy in many crisis countries will mean that the recovery for Europe as a whole will proceed slowly.

A decisive difference abroad, compared with the forecast in February is that the uncertainty in Europe, and particularly in the euro area, has declined. The effects of the measures taken must be seen in the long term. The debt write-off for Greece has been implemented and many austerity programmes are imminent for countries that risk failing to achieve their financial balance targets. In addition to the concrete measures taken in Greece and other problem countries, other decisions have been made in Europe in spring 2012 that have contributed to a stabilisation, said Ms af Jochnick.

The decision at the beginning of March on the treaty on stability, coordination and governance in the economic and monetary union, what is known as the fiscal pact, is a further step on the road to stricter discipline within the EU with regard to budget balance and convergence targets. Now it remains to be seen whether the agreement can be implemented smoothly.

At the end of March, the Eurogroup took an important decision regarding the firewall in Europe. This decision was important not least from a credibility point of view. Although many people would rather have seen an even larger firewall, the decision is very important for reducing the contagion risks in Europe in the event of a failure and thereby safeguarding financial stability.

The loans from the ECB in December 2011 and February 2012 have also contributed to the financial markets functioning better, continued Ms af Jochnick. The loans from the ECB contributed successfully to providing liquidity to the financial system and interest rates fell. However, in her opinion it was too early to draw any far-reaching conclusions regarding the effects of the loans. There is a risk that the extensive loans will merely postpone the underlying problems. The ECB's loans have not resolved the fundamental problems that Europe needs to resolve. However, they have enabled European governments and banks to buy time to take necessary measures. If credible measures are not taken, Europe will once again suffer problems with turbulence in its financial system.

In her opinion, there was reason to continue to fear setbacks for developments in the euro area. In addition to Greece, both Spain and Italy need to implement major structural changes, which will greatly test their policymakers.

All in all, Ms af Jochnick's assessment was that Europe is on the right path, but it is still a delicate balance. The crisis countries must consolidate their public finances, reinforce their competitiveness and capitalise their banking systems. It remains to be seen whether this can be achieved without the total effects hampering growth too much.

Deputy Governor **Per Jansson** made it clear that he supported the forecast for the economic outlook abroad presented in the draft Monetary Policy Update. As noted in the Update, the adjustments to the forecast were minor compared with the Monetary Policy Report published in February.

As before, the focus in recent months has been on the European debt crisis, said Mr Jansson, and this was what he wished to focus on in his comments regarding international developments.

As several others had done in their contributions to the debate, he commented on the plausibility of the key assumption in the forecast that "the European debt crisis will be managed in such a way that the unease gradually subsides in 2012".

Developments in Europe so far in 2012 can be described as taking two steps forward and one step backwards. At the beginning of the year the acute concern showed a tendency to calm down, and there was some stabilisation in international activity. The ECB's liquidity support, in the form of LTRO (Long Term Refinancing Operation) I and II, provided a substantial contribution here. Other significant factors were the Fiscal Compact aimed at stricter budget discipline at the European level; the agreement on a second support package to Greece, including so-called PSI (Private Sector Involvement); and the short-term strengthening of the European firewall through a decision to allow the ESFS and the ESM to coexist for a period of time.

But Mr Jansson pointed out that in recent weeks, concerns have increased again. This is partly because the economic outcomes in the euro area had offered some setbacks. The markets have also recently focused on budget developments and the management of bank problems in Spain. This has pushed up the spread for the Spanish 10-year government bond yield in relation to Germany by around 125 basis points since the introduction of LTRO II. During the same period, the Italian long-term interest spread against Germany has risen, by around 75 basis points.

Mr Jansson said that this development underlines a point he had already made at the monetary policy meeting in February, namely that national responsibility needs to be taken now to win the confidence of the financial markets. One should not underestimate the potential gains of winning market confidence and in this way bringing down risk premiums, which at present push up long-term bond yields.[1]

Support measures may provide some assistance, but they serve no purpose unless they are followed up with measures to deal with the real problems, including a lack of competitiveness, mismanaged public finances, problems with capital levels in the banks, and so on. The appropriate response to market mistrust from an economic policy point of view is action aimed at solutions combined with a high degree of openness with regard to the prevailing problems, according to Mr Jansson. Trying to hide the problems and postpone solutions is unfortunately a strategy that has been tried by many for a long period of time. One must hope that most people have now realised that this is not a sustainable strategy, but only leads to the problems returning, magnified many times over.

It is essential that this national responsibility is taken now, for our key assumption to apply, that is "the European debt crisis will be managed in such a way that the unease gradually subsides in 2012". We cannot assume that this will happen immediately, but it is important that steps are now gradually taken in the right direction, said Mr Jansson.

[1] See Baldacci and Kumar (2010), "Fiscal Deficits, Public Debt, and Sovereign Bond Yields", IMF Working Paper WP/10/184 and also Corsetti, Kuester, Meier and Mueller (2012), "Sovereign Risk, Fiscal Policy, and Macroeconomic Stability", IMF Working Paper WP/12/33.

Governor **Stefan Ingves** said that he shared the view of international developments presented in the draft Monetary Policy Update. Economic activity abroad has developed roughly as expected since the previous monetary policy meeting. There is thus no reason to make any major changes to the international economic outlook. The oil price has risen recently as a result of concern over supply shocks, and this means that inflation may be slightly higher in most countries over the coming year. However, GDP growth may be somewhat lower. But the changes are minor. The overall picture is still that international growth will rise gradually over the coming years.

But Mr Ingves felt that there were reasons to believe that the recovery will be fairly weak. Many countries need to tighten their fiscal policy to bring down budget deficits and sovereign debt. Households and companies also have large debts in many countries, and it is reasonable to believe that they need to reduce their debts in the coming period. The longer one postpones a necessary debt reduction, the greater is the risk of a more abrupt adjustment further ahead. This applies equally to households, companies and governments. It presents a difficult challenge for monetary policy. On the one hand, one needs a low interest rate to keep demand up. On the other hand, low interest rates mean that balance sheet consolidation is postponed.

With regard to economic developments in the euro area, several economic indicators, such as household and company confidence, have stabilised, but at fairly low levels. This indicates that GDP growth will continue to be weak in the coming period. The development of the real economy suggests a smaller downward revision to the forecast for growth in the euro area this year.

Mr Ingves said that the ECB's two rounds of three-year loans have probably facilitated funding for some European banks, but that it is difficult to say what effect they will have on growth prospects in the coming period. A number of measures have been taken to resolve the most acute problems and changes have been made to the institutional framework to prevent the current problems arising again. Despite this, there probably still remain many years of work before sustainable solutions are in place. The ECB offered loans on special terms for the first time in 2007, with the motivation that there were problems on the markets. After five years, and even larger loans, it is now more a question of dealing with structural problems – both in the banking sector and among the governments with sovereign debt problems. Such reconstruction work can easily become disjointed both within sectors and between countries. Of course, this makes the assessment of the economy more difficult, but Mr Ingves felt that the main scenario in the Monetary Policy Update is a reasonable one.

He said that developments in the United States have been more or less as expected. Both households and companies have become increasingly optimistic and unemployment has fallen. There are no reasons to make any major changes to the forecast for GDP growth in the United States.

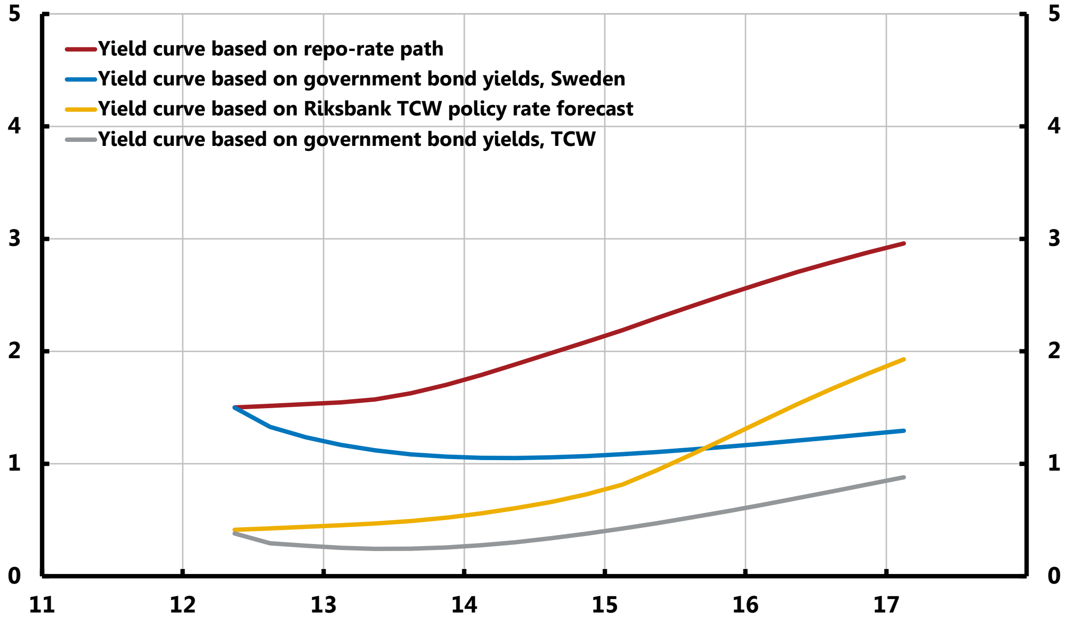
With regard to the impact from abroad on the Swedish economy, Mr Ingves said that one should not focus solely on the weak developments in southern Europe. Domestic demand in Asia, and particularly in China, has strengthened. This higher domestic demand means that growth in this region is less vulnerable to weak external demand. It also has a positive effect on the global imbalances. In the United States the current account deficit is currently lower than it was prior to the financial crisis. To compensate for lower demand from the United States, we need increased domestic demand in countries such as China, to uphold global demand. Another factor that indicates relatively good growth in the emerging economies in the coming period is that they have scope for more expansionary fiscal and monetary policy if demand should decline more than expected. Moreover, Asian banks are well-capitalised and therefore less vulnerable to problems in the European banking sector. High commodity prices are helping to keep up growth in Russia, for instance, and in a number of Latin American countries.

Deputy Governor **Lars E.O. Svensson** then commented on Ms Ekholm's contribution to the debate on the role played by the policy rate forecast further ahead and by the difference between this forecast and forward rates. To illustrate this he referred to Figure 2. The grey line shows the actual yield curve for TCW-weighted government securities abroad with a maturity of up to five years, while the yellow curve shows the yield curve compatible with the forecast for policy rates abroad in the draft Monetary Policy Update. The grey curve shows that a 5-year yield abroad is around 0.9 per cent. The yellow curve shows that a five-year yield compatible with the policy rate forecast is around 1.9 per cent, that is, 1 percentage point higher. To simplify, one can say that the forecast in the Monetary Policy Update assumes that five-year yields abroad are 1 percentage point higher than they actually are. One percentage point is a lot for a five-year yield and has a major impact on the real economy and the exchange rate. A rule of thumb is that a 1 percentage point higher five-year yield will have the same or a greater effect on the real economy as a 2 to 3 percentage point higher policy rate.[2]

[2] See pages 326-327 in Svensson, Lars E.O. (2011), "Practical Monetary Policy, Examples from Sweden and the United States", *Brookings Papers on Economic Activity*, Fall 2011, 289–332.

Figure 2. Yield curves, April 2012

Per cent. Government bond yields from 12 April



Sources: National sources, Reuters EcoWin, the Riksbank and own calculations

Figure 2 also shows the large difference that Mr Svensson has discussed earlier between the five-year Swedish government yield and the five-year yield that is compatible with a credible and already priced-in repo-rate path. If the repo-rate path were entirely credible, the five-year yield would increase by around 1.5 percentage points. He pointed out that this was a large increase and would have a very negative effect on the Swedish economy.

Deputy Governor **Barbro Wickman-Parak** commented on Mr Ingves contribution to the discussion by saying that she agreed with him that there are large differences in growth between different countries. There is a risk that the euro area will be treated as a whole, without giving consideration to regional differences. This applies to growth prospects, as well as the the need for fiscal policy tightening. Countries with major budget and debt problems have no other choice than to implement a strict policy. Other countries in a better initial situation, which are not subjected to market pressure, have a slightly greater degree of freedom. They need not necessarily be in a hurry to tighten their policy.

Governor **Stefan Ingves** agreed with Ms Ekholm regarding the great uncertainty in drawing far-reaching conclusions on the basis of a 0.5 percentage point difference in policy rates abroad three years ahead. Mr Ingves said that Mr Svensson's arguments and discussion of policy rates abroad in 2015 and further ahead, and the effects these would have on the Swedish krona and the repo-rate path are reflections that have not added very much to the monetary policy discussion. Mr Ingves said that Mr Svensson's arguments were conducted at a very abstractive level. Exchange rate forecasts are very uncertain and are made with a significant degree of judgement. It is thus not reliable to use only the results of model simulations to determine the effect of differences in policy rates abroad on exchange rates and the repo rate. Reality often looks quite different from the world portrayed in the model.

To summarise, Governor **Stefan Ingves** noted that GDP growth abroad is expected to be weak over the coming period and then to rise gradually. There are, however, major differences between different countries and regions. Growth in the emerging markets is expected to be relatively good in coming years. The recovery in the United States is expected to be much stronger than that in the euro area. The assessments made by Executive Board members differ somewhat with regard to the views on GDP growth, particularly with regard to the euro area. There are also different opinions regarding the forecasts for policy rates abroad.

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

Deputy Governor **Lars E.O. Svensson** began by noting that the messages in the draft Monetary Policy Update can be said to be "Some positive signs for the Swedish economy", ”Continued low inflation” and “Unchanged repo rate and repo-rate path”. Mr Svensson considered that the messages ”Too low inflation”, ”Too high unemployment” and ”Lower repo rate and repo-rate path provide better target fulfilment” would be better.

Mr Svensson said that it should be clear to many that it is difficult to get across the message that the unchanged repo rate in the main scenario constitutes a well-balanced monetary policy. Swedish inflation is the lowest in the EU, according to Statistics Sweden (SCB).[3] Unemployment is high and rising, long-term unemployment is high and the high unemployment risks becoming entrenched. As is well-known, the Riksbank shall conduct its monetary policy independently. But one can nevertheless note that the National Institute of Economic Research’s most recent Swedish Economy report shows that a lower repo-rate path entails a better monetary policy, that a unanimous "shadow Executive Board" in the Dagens Industri newspaper advocates a lower repo rate and that the Government’s Spring Fiscal Policy Bill contains a forecast for a lower repo-rate path. The Government’s Spring Fiscal Policy Bill also contains a not unrealistic alternative scenario with weaker international demand that leads to a much lower repo-rate path.

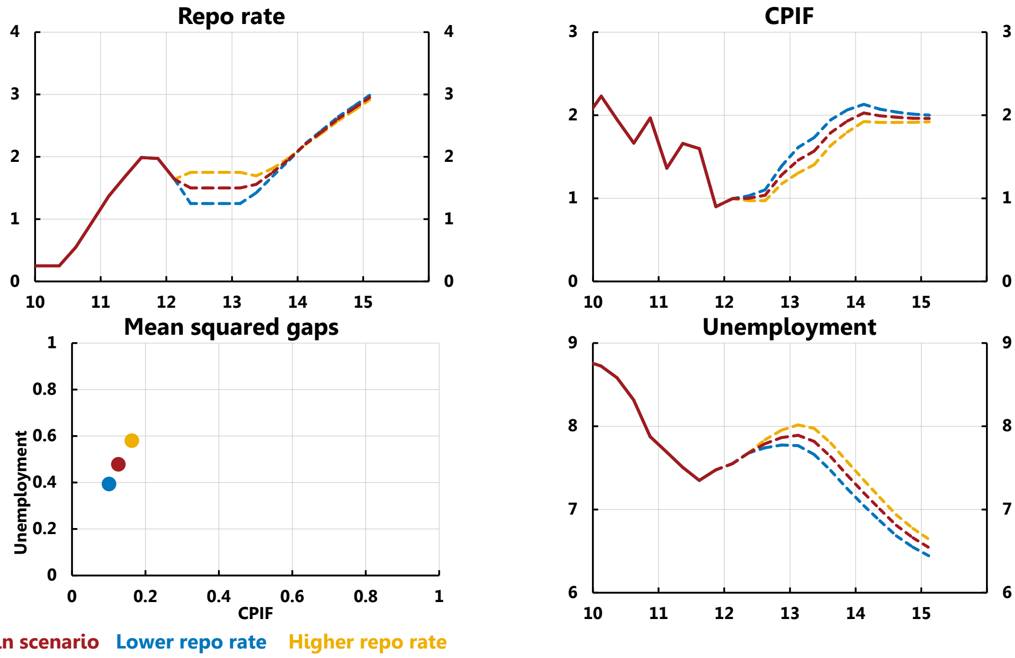
Mr Svensson also considered that even given the assumptions in the draft Monetary Policy Update regarding an overly optimistic forecast for GDP growth in the euro area and overly high future policy rates abroad, a lower repo-rate path would provide better

[3] SCB (2012), “SCB Economic indicators, [monthly economic survey for Sweden]”, Number 3, 30 March 2012.

target fulfilment for CPIF inflation and unemployment. This is illustrated clearly in Figure 3, which shows the main scenario and forecasts for alternative repo-rate paths with the aid of the Riksbank's model, Ramses. This conclusion also applies if one assumes that inflation and unemployment react more slowly to interest rate changes than is the case in the Ramses model. If the reaction is slower, this is an argument in favour of a larger and earlier cut in the repo rate.

Figure 3. Monetary policy alternatives, April 2012

Policy rates abroad according to the main scenario. Long-term sustainable unemployment 6.5%

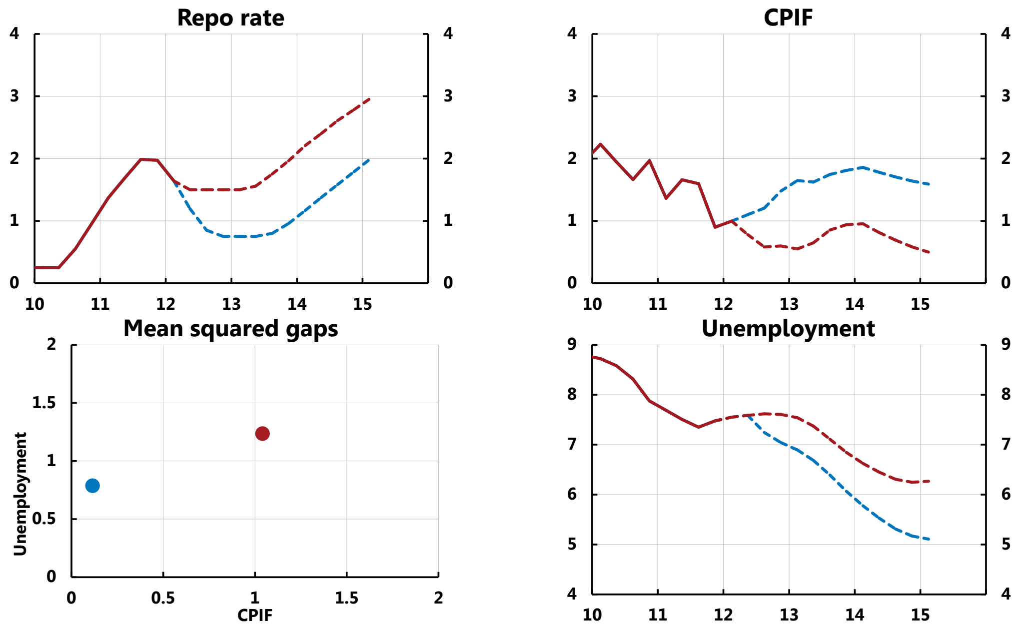


Sources: Statistics Sweden and the Riksbank

A forecast for policy rates abroad in line with forward rates, which Mr Svensson currently considers to be a more realistic forecast, argues in favour of a much lower repo-rate path, he said. This is illustrated in Figure 4, which assumes policy rates abroad will follow forward rates and that the long-term sustainable unemployment rate is 5.5 per cent. Mr Svensson pointed out that the lower repo-rate path leads to much better target fulfilment for CPIF inflation and unemployment. A less optimistic forecast for the euro area gives further arguments in favour of a lower repo-rate path. Mr Svensson emphasised that this conclusion is not sensitive to the assumption regarding the long-term sustainable unemployment rate, but remains the same even if one assumes a sustainable unemployment rate of 6.5 per cent.

Figure 4. Monetary policy alternatives, April 2012

Policy rates abroad according to implied forward rates. Long-term sustainable unemployment 5.5 %



Sources: Statistics Sweden and the Riksbank

Given these arguments, Mr Svensson entered a reservation against the Monetary Policy Update and the repo-rate path. He preferred cutting the repo rate by 0.5 percentage points to 1 per cent and then a repo-rate path that stays at 0.75 per cent from the third quarter of 2012 through the third quarter of 2013, and then rises gradually to 2 per cent by the end of the forecast period.

Mr Svensson then took up three issues of principle. Firstly, principles for how monetary policy should be conducted and assessed, secondly, that one should not forget that the monetary policy decision-making process consists of two distinct stages, and finally that one should not forget the longer-run perspective in monetary policy.

Mr Svensson began with the principles for monetary policy and its assessment. On 4 April the Executive Board decided on the material for assessing monetary policy that is sent each year to the Riksdag, the Swedish parliament. The Riksbank has the task of independently meeting the targets expressed in the Sveriges Riksbank Act and its preparatory works. As the Riksbank is an authority under the Riksdag, with a unique independence, a democratic control of the Riksbank requires a thorough investigation of whether monetary policy best meets the targets expressed in the Sveriges Riksbank Act and its preparatory works to enable the members of the Executive Board to be held accountable for the monetary policy they have conducted.

An assessment of monetary policy is made easier if it is clear and easy to understand. According to Mr Svensson, in practice the Riksbank's monetary policy has unfortunately become unclear and difficult to understand for several reasons. Examples that can be mentioned are that CPI inflation is confused with CPIF inflation, and that unclear, irrelevant and qualitative measures of resource utilisation are confused with unemployment. The fact that the Government Bill 1997/98:40 about the status of the Riksbank contains clear instructions appears to be forgotten. There are often references to target fulfilment at the end of the forecast period instead of during the entire forecast period. But for an unemployed person there is a major difference between getting a job in one or two years' time and getting one in three years' time. There are also unclear references to house prices, household indebtedness and financial stability.

What inflation measure should be used? There is a generally-accepted principle that within the period of a couple of years, CPIF inflation is most relevant. The reason for this is that in the short term, CPI inflation is affected directly by the Riksbank's own repo-rate adjustments and that monetary policy should not react to these temporary effects. In the longer term, these effects largely subside and then it is CPI inflation that is most relevant. This is entirely in line with the recommendation in the assessment made by Goodhart and Rochet,[4] a recommendation which the Riksbank agreed with in its consultation response.

Mr Svensson reminded the meeting that he usually emphasises that, in addition to stabilising inflation around the target, it is important to stabilise unemployment around a sustainable rate. Why unemployment? Well, the Government Bill (page 51) states that the Riksbank should, without neglecting the price stability target, support general economic policy with the purpose of attaining "high employment". "High employment" of course means "the highest possible sustainable level of employment". Stabilising employment around a sustainable path is the same thing as stabilising unemployment around a sustainable rate, more precisely adjusted for the labour force gap if this is not so small that it can be ignored.[5] The Government Bill thus provides clear support for focussing on employment and thus unemployment, Mr Svensson maintained.

Mr Svensson explained that he cannot see that there is any support in the Sveriges Riksbank Act or in the Government Bill for instead of unemployment as a target variable focussing on the qualitative assessment of resource utilisation based on a number of different measures, as is now the case. This merely has the effect that one is confusing the issue, making it more difficult to assess the policy and to hold the Riksbank accountable. Mr Svensson does not see that there is any support for a qualitative assessment instead of a quantitative, measurable target fulfilment. In economic policy it is now well-known that a target must be measured quantitatively to be given sufficient weight and to be attained in practice. "What is measured gets done," as they say. This is why there are inflation

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[4] Goodhart, Charles and Rochet, Jean-Charles (2011), Assessment of the Riksbank's monetary policy and work with financial stability 2005-2010, 2010/11:RFR5.

[5] The labour force gap refers to the difference between the actual and potential labour force.

targets and in fiscal policy an endeavour to attain measureable surplus targets for public finances. Mr Svensson therefore considered it important to have a measurable quantitative target fulfilment not only for inflation, but also for unemployment. One should thus focus on unemployment in relation to an estimated long-run sustainable unemployment rate. Moreover, Mr Svensson pointed out that, in relation to other indicators of resource utilisation, unemployment has greater welfare relevance, is better known and understood and has less measurement errors than, for instance, GDP and the GDP gap.

The principle for conducting monetary policy should thus be to choose the repo-rate path that best stabilises, during the forecast period, both CPIF inflation around the target of 2 per cent and unemployment around an estimated long-run sustainable rate. Monetary policy should then be assessed on the basis of to what extent it follows this principle.

The second issue of principle Mr Svensson discussed concerns not forgetting that the monetary policy decision-making process consists of two stages. This is because inflation and unemployment are affected by both factors that are independent of the repo rate and the repo-rate path and by the actual repo rate and the repo-rate path.

Stage 1 consists of an assessment of the factors that are independent of the repo rate and the repo-rate path – an assessment of the current situation and outlook in the Swedish economy and abroad. In practice this stage consists of assessing the current situation in the Swedish economy and abroad and making mean forecasts for inflation, GDP and interest rates abroad, as well as quantities such as propensity to consume and invest, productivity, cost and inflationary impulses, fiscal policy and so on in the Swedish economy.

Stage 2 consists, given the results of the first stage, of choosing a repo-rate path that best meets the targets for monetary policy, that is, choosing between different policy alternatives, what is often referred to as "policy action". This means, according to the principles for monetary policy mentioned above, choosing a repo-rate path that ensures the corresponding forecasts for inflation and unemployment fulfil the targets for monetary policy in the best possible way. Stage 2 often consists in practice of choosing between higher or lower repo-rate paths and ensuring, when choosing a path, that neither a higher nor a lower path than the one chosen would provide better target fulfilment.

The first stage is the same for all forecasting work. The second stage, the choice between different policy alternatives, is the one specific to monetary policy and it is the actual core of monetary policy.

According to Mr Svensson it is remarkable that the second stage is given relatively little scope in the Riksbank's monetary policy process and also in the material for assessing monetary policy. Mr Svensson emphasised that he would like to see a serious and detailed discussion of various policy alternatives, with reference to the one that provides the best target fulfilment.

Given this, Mr Svensson pointed to the four-panel figures shown in Figures 3 and 4 and similar figures shown at earlier monetary policy meetings. They summarise the choices available in stage 2 for the given results of stage 1, by reporting alternative repo-rate paths and corresponding forecasts for CPIF inflation and unemployment, as well as the mean squared gap, which can be used when necessary as a measure of how well inflation and unemployment are stabilised. Given the above reasoning, these figures become central to monetary policy; with regard to the actual policy choice, that is, the choice of repo-rate path, with regard to justifying the monetary policy decision, and with regard to assessing monetary policy. Mr Svensson found it remarkable that the only Executive Board members who usually refer to and justify their choice on the basis of these diagrams and policy alternatives are himself and Ms Ekholm.

Finally, Mr Svensson pointed to the importance of not forgetting a longer run perspective in monetary policy. He maintained that it is important to also have a longer-run perspective in each monetary policy decision. Assessments of monetary policy should also take a longer-run perspective. Then it is important to examine the average level and stability of CPI inflation and unemployment in the longer run.

In this context it is, of course, desirable that the average CPI inflation rate is 2 per cent. During the period 1996-2011, however, average CPI inflation has been 1.4 per cent when measured using real-time data. Because of the introduction of a new method of calculating the inflation rate with effect from 2005, the average inflation rate is 1.3 per cent if measured using the new method during the same period, but real-time data are more relevant when assessing monetary policy.

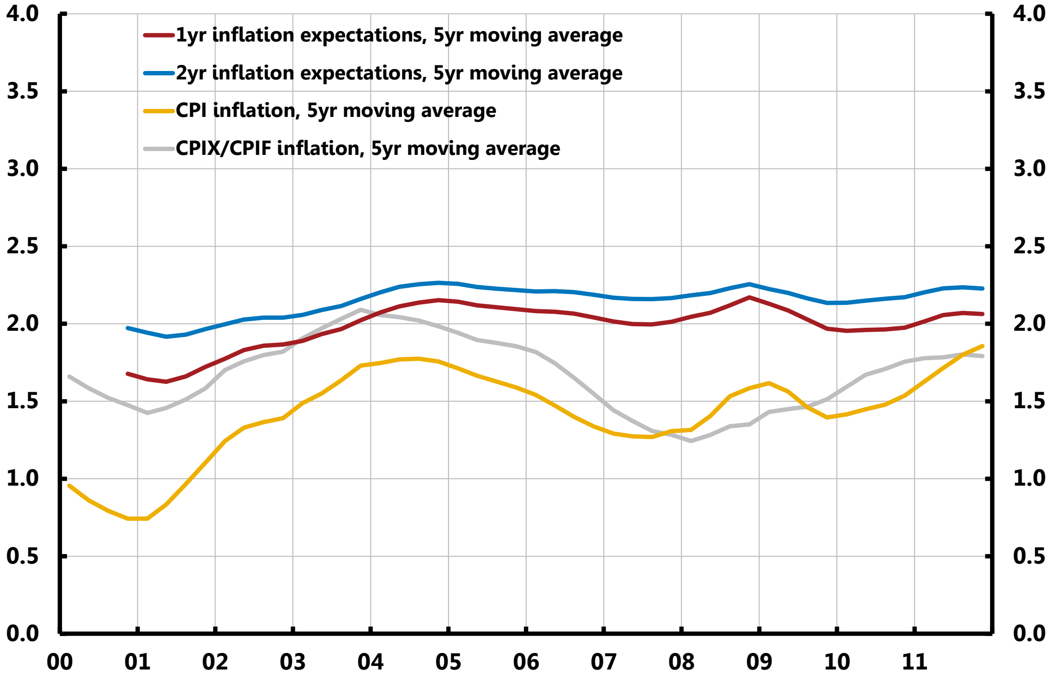
Mr Svensson emphasised that it is of course not good to systematically miss the target over a period of 16 years. But he pointed out that, as he briefly mentioned at the monetary policy meeting in February, perhaps the most important question is whether missing the target also led to costs for the real economy. Does monetary policy have long-term effects on unemployment (disregarding persistency effects and so on that subside after a number of years)?

The standard response is that average unemployment is independent of monetary policy and the inflation rate. This is because inflation expectations are assumed to adapt to the actual inflation. In that case, the long-term Phillips curve becomes vertical, and average unemployment becomes independent of the average inflation rate.

In Sweden, however, inflation expectations as measured by TNS Sifo Prospera's survey have stabilised around 2 per cent, despite the average inflation rate being lower. This is illustrated in Figure 5, which shows the five-year average of Prospera's expectations one and two years ahead for all of those interviewed from 1996. It also shows the five-year average for CPI inflation and CPIX/CPIF inflation (CPIX inflation up to the end of March 2008, CPIF inflation with effect from April 2008).[6] The Riksbank has thus succeeded in anchoring inflation expectations around 2 per cent, despite actual inflation being lower on average. Mr Svensson said that the fact that inflation expectations have been anchored is in itself good, and enables the Riksbank to better stabilise unemployment without inflation fluctuating too much.

Figure 5. Inflation expectations and inflation

Annual percentage change, 5-year moving average



Note. The CPIX/CPIF series is constructed using CPIX inflation up to the end of March 2008 and CPIF inflation with effect from April 2008.

Sources: Statistics Sweden and TNS SIFO Prospera.

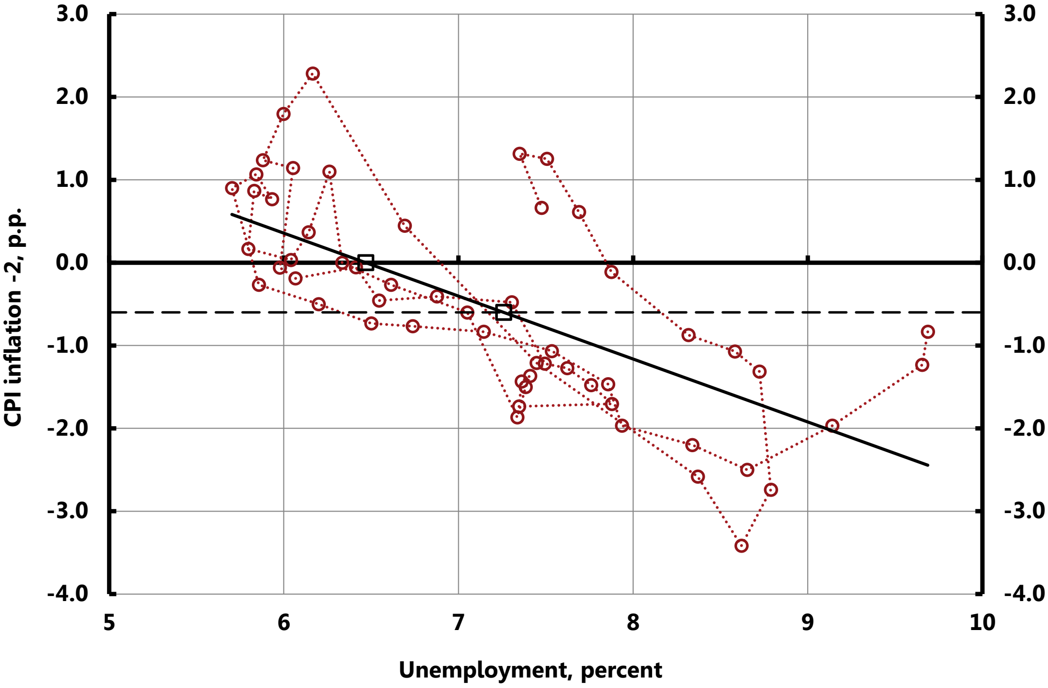
The fact that inflation expectations have anchored at a different level than the realised inflation also means that the long-run Phillips curve is no longer vertical, but slopes downwards. This is illustrated in Figure 6. The red circles show the outcome for unemployment and the gap between CPI inflation and the target of 2 per cent from the first quarter of 1998 and up to the end of the fourth quarter of 2011. The black line is an

[6] The CPIX excludes the effects of indirect taxes and subsidies and mortgage expenditure from the CPI. The CPIF excludes the direct effects on the CPI of changes in mortgage rates.

estimated long-run Phillips curve. The fact that the long-run Phillips curve is no longer vertical has also been noted for the United States since 2000 in a policy brief by Jeffrey Fuhrer at the Federal Reserve Bank of Boston.[7]

Figure 6. Downward-sloping Phillips curve

Sample 1998 Q1-2011 Q4



Sources: Statistics Sweden and own calculations.

The right-hand square on the long-run Phillips curve corresponds to an average inflation rate of 0.6 percentage points below the target, which gives an average unemployment rate of 7.3 per cent. The left-hand square corresponds to an average inflation rate that is on target, which gives an average unemployment rate of 6.5 per cent. The difference is 0.8 percentage points. Thus, for Sweden an average inflation rate that is 0.6 percentage points lower appears to have led to an average unemployment rate that is 0.8 percentage points higher over the past 16 years. This estimate appears fairly robust for various assumptions. A preliminary analysis with more details can be found in Svensson (2012).[8]

The robustness of this result and the policy implications it may entail should, of course, be examined more closely. Mr Svensson said that a reasonable policy conclusion is that it is very important to ensure, going forward, that average inflation will be in line with the target and to see the target as a central point, as symmetrical, rather than as a ceiling and

[7] Fuhrer, Jeffrey (2011), "Inflation Expectations and the Evolution of U.S. Inflation", Policy Brief No. 11-4, Federal Reserve Bank of Boston, www.bos.frb.org.

[8] Svensson, Lars E.O. (2012), "The possible unemployment cost of average inflation below a credible target", working paper, www.larseosvensson.net.

as asymmetrical. Another possible conclusion that Mr Svensson highlighted was that estimates of long-run sustainable unemployment rates based on historical averages could have become around 0.8 percentage points too high. In this case, perhaps the Riksbank's estimate of a long-run sustainable unemployment rate of 6.5 per cent should instead be 5.7 per cent, not far from the National Institute of Economic Research's estimate in December 2011 of 5.8 per cent, and from Mr Svensson's own preliminary assessment in autumn 2010 of 5.5 per cent.

Deputy Governor **Karolina Ekholm** began by saying that she, like Mr Svensson, found it difficult to see any reasons why the repo rate and the repo-rate path should be held unchanged. Inflationary pressures are low at present and, as pointed out in the draft Monetary Policy Update, are expected to remain so for a large part of the forecast period. CPIF inflation is not expected to reach 2 per cent until late 2013. Resource utilisation is also expected to be lower than normal more or less throughout the forecast period. Unemployment, for example, is expected to increase this year and it is not assessed to fall back to 6.5 per cent until the end of the forecast period.

Ms Ekholm said that in such a situation it does not appear to be compatible with good target fulfilment to hold the repo rate and the repo-rate path unchanged. A lower repo rate would bring inflation closer to the inflation target and resource utilisation closer to a level that is sustainable in the long term.

Ms Ekholm said that she therefore did not support the repo-rate path in the draft Monetary Policy Update but advocated a repo-rate cut today and a lower repo-rate path. She stressed that so far she was convinced that this was the right thing to do in this situation. However, Ms Ekholm said that she thought it was much more difficult to take a stance on how much the repo rate should be cut today, how far down the repo-rate path should be shifted and how long it should remain at this lower level.

On the one hand, she said that it feels more comfortable to advocate small changes in the repo rate, such as a change of 0.25 percentage points. Changes of this magnitude have been made on several occasions previously and they do not seem unusual or signal that the situation is much worse than was previously assessed.

On the other hand, monetary policy acts with such a time lag that it is difficult to believe that the low rate of inflation and higher rate of unemployment described in the draft Monetary Policy Update for the year immediately ahead could be effectively counteracted unless the repo rate is cut more than just marginally now. A possible criticism of the model analyses of alternative repo-rate paths discussed at the monetary policy meetings is that they are based on a monetary policy response that is unrealistically rapid. If this is the case, Ms Ekholm said that there is a risk of failing to bring CPIF inflation up to 2 per cent, and of failing to reduce unemployment from its current level above the sustainable rate, if the repo is not cut more substantially in the current situation. However, it is an open question whether the monetary policy response in Ramses is unrealistically rapid and Ms Ekholm pointed out the importance of investigating this thoroughly. This is work that is done by the Monetary Policy Department and Ms Ekholm pointed out that it must be allowed to take time.

All in all, Ms Ekholm believed that the arguments for moving more quickly ahead with repo-rate cuts outweigh the arguments against. She therefore advocated a cut of 0.5 percentage points, that is a repo rate of 1 per cent, and a path that remains at this level until the third quarter of 2013. Ms Ekholm said that this is consistent with the opinion she expressed at the monetary policy meeting in February, when she advocated a repo rate of 1.25 per cent and a repo-rate path that fell to 1 per cent. Her assessment was that it was as likely that further repo-rate cuts will be needed in the period ahead as it was that the repo rate will need to be raised, so she therefore still believed that the repo-rate path should bottom out at 1 per cent. Ms Ekholm considered that it should then rise gradually, as in the draft Monetary Policy Update, and she advocated a path that would reach 2.25 per cent at the end of the forecast period.

Ms Ekholm then discussed why she advocated a repo-rate path that reaches 2.25 per cent at the end of the forecast period. As the forecast for policy rates abroad is uncertain, it would be good if it were possible to choose a path that provides reasonable target fulfilment with both the current TCW path for policy rates abroad and a forecast entirely based on forward rates. However, it is difficult to know exactly what form such a path should take as the difference in the forecast outcomes for inflation and resource utilisation is so large in the model runs. In arriving at the assessment of an appropriate repo-rate path that ends at 2.25 per cent, Ms Ekholm attached somewhat greater importance to a forecast for foreign policy rates entirely based on forward rates than to the actual TCW-weighted policy-rate path. However, she emphasised that this assessment is not based on any sophisticated analysis. But as we are talking about a forecast for the repo rate three years ahead, Ms Ekholm emphasised that there will be plenty of time to revise it as more information about developments in the economy becomes available.

To sum up, Ms Ekholm thus advocated a repo-rate cut of 0.5 percentage points and a repo-rate path that remains at 1 per cent until the third quarter of 2013 and then gradually rises to 2.25 per cent at the end of the forecast period. This is a repo-rate path associated with a higher forecast for CPIF inflation and resource utilisation that, according to Ms Ekholm, constitutes a better-balanced monetary policy than the repo-rate path proposed in the draft Monetary Policy Update. Ms Ekholm judged that this conclusion applies irrespective of whether foreign policy rates are forecast only on the basis of implied forward rates or with the method used in the draft Monetary Policy Update.

Deputy Governor **Kerstin af Jochnick** said that she shared the assessment of the Swedish economy presented in the draft Monetary Policy Update and that she supported the proposal to hold the repo rate unchanged at 1.5 per cent and to hold the repo-rate path unchanged.

The assessment of the Swedish economy that the Executive Board made in connection with the monetary policy meeting in February still holds up rather well. Growth in the Swedish economy will be low in 2012 but is expected to pick up in 2013. New statistics published after the repo-rate decision in February support the assessment, although the picture of the situation in the Swedish economy is mixed. There are therefore good reasons to be cautious about drawing too far-reaching conclusions on the basis of specific figures.

Demand from abroad will be low during the coming period. This assessment is supported by the weak developments on many of Sweden's export markets and by statistics on new orders. However, households' and companies' confidence in the future has risen during the spring. The National Institute of Economic Research's Economic Tendency Survey in March was much more positive than expected. At the same time, there are statistics that point in the opposite direction. Ms af Jochnick highlighted the figures recently reported by Statistics Sweden for industrial production in February, which were much more negative than expected, although this was mainly due to temporary factors.

One difference from the assessment made in February is that the forecast includes some cost pressures in 2012. This comes primarily from increased labour costs and higher oil prices.

In a recent report, the European Commission identified Sweden as a member state with potential macroeconomic imbalances.[9] Although this does not have any direct bearing on the monetary policy decision, Ms af Jochnick wanted to make a comment on the Commission's report with regard to Sweden. The report points to rising housing prices and to high household indebtedness. The Commission's analysis is based on indicators and Sweden stands out in relation to other countries in these identified areas. Ms af Jochnick assesses that there are good reasons that can explain both the rising housing prices and household indebtedness. With regard to housing prices, she referred to the Riksbank's report published in 2011[10] and with regard to household indebtedness, Finansinspektionen (the Swedish Financial Supervisory Authority) has recently shown in a report that households are well-equipped to manage their loans even at higher interest rates than now.[11] Nevertheless, Ms af Jochnick considered it important to be vigilant, as

[9] European Commission (2012), *Alert Mechanism Report.*

[10] Sveriges Riksbank (2011), The Riksbank's commission of inquiry into risks on the Swedish housing market, Stockholm April 2011.

[11] Finansinspektionen (2012), *Den svenska bolånemarknaden (The Swedish mortgage market)*, Report 13 March 2012.

long-term low interest rates could contribute to households increasing the rate of their indebtedness as they become more optimistic about the future.

Ms af Jochnick emphasised that she is aware that monetary policy does not aim to limit household indebtedness, but she nevertheless considers that the Executive Board should take into account possible negative effects and incentives that may be offered by low interest rates over time. This is an area that macroprudential policy should primarily analyse and assess.[12]

All in all, Ms af Jochnick assessed that the economic prospects and outlook for inflation are largely unchanged from February. Resource utilisation in the economy will remain low in 2012 and unemployment will continue to increase somewhat. CPIF inflation will remain low in 2012, but will rise to reach 2 per cent in 2014.

Deputy Governor **Per Jansson** began by pointing out that the monetary policy decision has been neither self-evident nor a simple one to make and that as he sees it, there is a choice between two different alternatives. The first entails holding the repo-rate path the same as in the Monetary Policy Report in February. The second entails cutting the repo rate by 0.25 percentage points and letting it remain at this slightly lower level for around one year. The latter alternative was a path for the repo rate that has been discussed during the forecasting round, and which gradually emerged as a reasonable alternative to the repo-rate path described in the February Monetary Policy Report.

Mr Jansson first highlighted the inflation picture and noted that developments so far this year have on the whole been in line with the assessment made in the February report. Although the outcome in January was slightly lower than expected, this forecasting error has been eliminated by unexpectedly high outcomes in February and March. This points, all else being equal, to the repo-rate path in the February Monetary Policy Report still applying.

When it comes to developments in the real economy, the picture is somewhat blurred in the short term. On the one hand, a number of indicators – such as the National Institute of Economic Research's Economic Tendency Survey, the retail trade, and foreign trade statistics – point to the Swedish economy speeding up at the beginning of 2012. The National Institute of Economic Research's Economic Tendency Survey for March in particular was extremely strong, with an increase in the so-called economic tendency indicator of a good 8 units. This increase is the largest change in the indicator since the monthly surveys began in 1996. It was the second month in a row that the survey indicator rose and it is now around 2 units above its historical average. On the other hand, industrial production showed a large reverse in February, falling 5.2 per cent

[12] Macroprudential policy is aimed at detecting, analysing and mitigating risks to the financial system as a whole, unlike the traditional financial supervision, which focuses on the state of health of the individual institutions.

compared with January. New orders in industry also fell substantially, by 5.5 per cent compared with January.

A systematic analysis of all new monthly indicators since the Monetary Policy Report was published in February shows that quarter-on-quarter GDP growth should land around 0.5 per cent for the first quarter of 2012. This is an indicator-based GDP growth that is a good bit higher than the one derived prior to the assessment in February. It means that the indicators are pointing towards a higher rate of activity in the Swedish economy, even when the analysis includes the weak industry outcomes. As Statistics Sweden claims that the industry outcomes are affected by "falls in production that appear to be temporary" and by "uncertain estimates", Mr Jansson considered that it was moreover not entirely clear that one should take the weak industry outcomes into account, at least not fully.[13]

All in all, the forecast for short-term GDP growth in the draft Monetary Policy Update is that it is expected to amount to around 0.4 per cent per quarter during the first half of 2012. This is a clearly higher growth rate than predicted in the Monetary Policy Report in February, where growth during the first half of 2012 was expected to be just over 0 per cent per quarter. According to Mr Jansson, this means that growth in the short term does not indicate that the repo-rate path in the February Monetary Policy Report is too high.

Looking at developments in the real economy slightly further ahead, the forecast for GDP growth is revised down a few tenths for both 2013 and 2014, compared with the assessment in February. But this revision in the growth forecast is to a large extent due to Statistics Sweden making an upward adjustment to the number of hours worked from 2010 and onwards. This has in turn been interpreted in the forecast to imply that the productivity growth trend is lower than was forecast previously.

Mr Jansson said that there was not very much monetary policy could do regarding a lower productivity growth trend. This instead emphasises the need for a higher trend growth of hours worked, by increasing the labour supply and the number of jobs with the aid of structural reforms that enable the labour market to function better. Given this background, Mr Jansson considers it somewhat worrying that wage formation is already showing considerable friction at an unemployment rate of around 7.5 per cent. According to Mr Jansson, this friction means that one must question whether the Swedish labour market, as it functions now, would be able to cope with a low long-term unemployment rate.

[13] Statistics Sweden (2012), New orders and deliveries in industry, February 2012: New orders decreased, Press release from Statistics Sweden 10 April 2012, No. 2012:87 and Statistics Sweden (2012), Industrial production index (IPI), February 2012: Decreased industrial production, Press release 10 April 2012 No. 2012:88.

All in all, Mr Jansson observed that neither the inflation outlook nor the picture of developments in the real economy indicates that the repo-rate path described in February needs to be changed. It should be pointed out that this repo-rate path entails a very expansionary monetary policy with a negative real repo rate during a large part of the forecast period. Mr Jansson said that it is important to point this out, as it often appears within the debate that the main discussion centres on whether or not monetary policy should be expansionary. But in actual fact, it is merely a question of how expansionary monetary policy should be. Mr Jansson noted that he had so far not heard anyone propose that the alternative is a tight monetary policy.

He further emphasised that he was essentially not any less worried now than he had been in February over what a very low repo rate over a long period of time might entail for the functioning of the economy. As at the previous meeting, he noted however that the risks connected with a low repo rate currently appear to be under control.

In conclusion, Mr Jansson mentioned a further aspect that on the margin had some significance for the choice between holding the repo rate unchanged and cutting it. He noted that one of the points of cutting the repo rate is to stimulate households into increasing their credit and loans. We probably all want GDP growth to increase, but it would be much better if it grew as a result of higher growth abroad rather than households increasing their indebtedness. Household debt as a share of disposable income has increased from around 90 per cent in the mid-1990s to around 170 per cent at the end of 2011. During the forecast period, conditional on the repo-rate path described in the draft Monetary Policy Update, the debt ratio will increase slightly further as loans will continue to increase at a faster rate than disposable incomes. All else being equal, this entails greater vulnerability in the Swedish economy. An even lower repo-rate path would add to this, which Mr Jansson felt cannot be disregarded.

Mr Jansson observed that the conclusion of all this is that he supports the decision not to change the repo rate and to stand by the repo-rate path contained in the Monetary Policy Report in February.

Mr Jansson then commented on Mr Svensson's contribution to the discussion regarding issues of principle. Mr Jansson said that he did not really understand the point of taking up these issues at the monetary policy meeting. These are questions that can be discussed at length, but there is not enough time available at a meeting of this nature. Mr Jansson said that Mr Svensson makes it sound as though the Executive Board has never discussed these issues before, which he considers to be totally misleading. These questions have often come up for lively discussion in recent years, and several of them have also led to concrete projects in the departments' business plans. It is important that those outside the Riksbank are not given the impression that the Riksbank never talks about these issues.

As a general comment on Mr Svensson's contribution regarding issues of principle, Mr Jansson said that he considers it important not to confuse what is right and what is wrong with different people having different opinions on difficult matters that do not have self-evident answers.

As a more specific comment on Mr Svensson's reasoning around the deviation in inflation from the target, and the so-called long-run Phillips curve, Mr Jansson put forward a number of lines of thought. As when this question was discussed at the monetary policy meeting in February, Mr Jansson stated that it is important not to forget the situation in the 1970s and 1980s when the tenths of a deviation from the inflation target were discussed. He felt that from this perspective it is difficult to draw the conclusion that monetary policy is now a failure. Mr Jansson discussed this in detail at the monetary policy meeting in February, so he found no reason to repeat it now.

Mr Jansson considered that the new calculations presented by Mr Svensson rely on a number of assumptions that are rather difficult to digest. Firstly, it is assumed that the Riksbank for some reason should want to deliberately and systematically aim to attain a different inflation rate than the one it has chosen to introduce as a target. Disregarding the fact that this would appear to lack logic, it is something that Mr Jansson does not recognise at all from his almost 15 years of working at the Riksbank. Secondly, it is assumed that the economic agents never understand that the Riksbank has a hidden agenda, of systematically undershooting the inflation target. According to this assumption, the economic agents continue to believe all of the time that inflation will be 2 per cent, despite the Riksbank choosing to deliver a different rate, year after year. It is important to emphasise that the agents are thus assumed to never understand what the Riksbank is actually doing. If they were to do so, the long-term effects on unemployment would disappear according to this theory, and the only consequence would be that inflation is lower in the longer run.

So what explains the fact that inflation expectations remain at 2 per cent? Mr Jansson said that the answer partly lies in the factors he has already mentioned. The economic agents trust the Riksbank to do its best to attain the inflation target. They understand that it is not easy to steer inflation with any great level of precision. They understand that there may be periods when special circumstances cause inflation to deviate from the target, but they do not assume these deviations are systematic. In actual fact, this is one of the strengths of the inflation-targeting regime; if the inflation target is credible, then there is no strong link between actual inflation and inflation expectations further ahead.

Given this, Mr Jansson's assessment was that it is very doubtful whether these new calculations can be considered to have any empirical relevance.

Deputy Governor **Barbro Wickman-Parak** began by commenting on Mr Svensson's reasoning that actual inflation has deviated from the target, and she emphasised the importance of a more in-depth analysis to see what causes lie behind the deviations. When discussing the target fulfilment of monetary policy, it is also important to understand that monetary policy cannot be used to fine-tune inflation or resource utilisation. Ms Wickman-Parak said that the mean squared gap on which Mr Svensson bases his analysis gives a false impression of precision and simplicity.

In addition, Ms Wickman-Parak referred to Mr Jansson's reasoning on whether or not monetary policy decisions are simple and she pointed out that the current decision has not been simple for her either.

As an economic analyst, one is confronted by a constant flow of new statistics that often point in different directions. Moreover, revisions to statistics can change our view of past events and throw new light on the current situation in the economy. A couple of examples from the flow of statistics since February can illustrate this rather well. As soon as Statistics Sweden published a GDP figure for the fourth quarter that was weaker than expected, the National Institute of Economic Research published a very strong Economic Tendency Survey. Ms Wickman-Parak also highlighted an example of the revisions to statistics. Statistics Sweden’s upward revision to the number of hours worked paints a new picture of productivity, which appears to have had a lower growth than reported earlier both in 2010 and 2011. As Mr Jansson pointed out, the revision entails a different assessment of the future productivity growth trend.

Ms Wickman-Parak said that at usual it is important not to read too much into individual figures, but to weigh together all of the information to form an idea of the current situation and the driving forces going ahead. This requires well-structured processes in the forecasting work and a staff that does this work in a thorough and professional manner, which the Riksbank has. Mr Svensson mentioned in his contribution the different stages in the forecasting work to determine the most appropriate repo-rate path. This is how the forecasting work is conducted now.

The Riksbank has long been predicting that 2012 will be a year of weak growth. The Monetary Policy Report published in February contained a forecast for GDP growth of 0.7 per cent. It is now expected to be 0.4 per cent. This revision is connected to the unexpectedly weak outcome at the end of last year, which in turn was due to an unexpectedly large fall in exports. Once again, we have an illustration of how a small, export-dependent economy can experience a sudden and hard impact from a decline in economic activity abroad. If one looks at the GDP figure on its own, it appears ominous. But, Ms Wickman-Parak points out that the outcome for domestic demand was in line with the Riksbank’s forecast. Later figures for the retail trade and increased confidence among households also point towards consumption picking up, even if the assessment means that it will take some time before it really accelerates. Moreover, the figures for the first two months of the year have shown that exports of goods are increasing again.

Despite this, it is reasonable to expect a continuing weak increase in exports, given the weak export orders.

The National Institute of Economic Research's Economic Tendency Survey was, as mentioned earlier, surprisingly strong and this applied to all sectors. However, the strength of the upturn should be interpreted with caution. Such figures can fluctuate and this is particularly so in sensitive situations. But when Ms Wickman-Parak weighs together the figures that have come in since February, her assessment is that economic prospects have become marginally brighter. This may appear strange if one looks carefully at the forecast, which she is supporting, and sees that the growth forecast for 2013 and 2014 is slightly weaker than in February. This is partly because the productivity trend is expected to be lower, which entails a lower growth rate trend for GDP. This picture is supported by Statistics Sweden's recently-mentioned downward revision of the figure for productivity growth.

To summarise, Ms Wickman-Parak said that the economic outlook and the view of resource utilisation were roughly the same as in February. The same applies to inflation prospects. The repo-rate path decided in February still appears reasonable. It entails an expansionary monetary policy with a negative real repo rate for some time to come.

The fact that underlying inflation is low, and will remain so for the coming period, has been included in the Riksbank's forecasts earlier. The strong appreciation of the krona that followed in the wake of the Lehman crash offers one explanation for this. Low unit labour costs provide another explanation, but a turnaround is now taking place. Although the krona is expected to appreciate somewhat, the effects are not large. Ms Wickman-Parak said that current inflation is receiving a little too much focus in the monetary policy debate.

Ms Wickman-Parak also said that when one looks back at monetary policy over the past year, it has followed the course of the economic cycle. When, for instance, uncertainty abroad increased and indicators in Sweden also began to show some weakening, the repo rate was held unchanged, despite the fact that outcome data was still strong. When the slowdown became clearer, it was cut. This is a good approach, according to Ms Wickman-Parak. It is important to gradually revise the forecasts as new information is received, to "keep a cool head" when the general sentiment suddenly changes and not to read too much into individual figures. The Riksbank's current forecast follows this approach. This approach, like the awareness that the picture of the economic reality may afterwards be shown to be wrong, is a factor that Ms Wickman-Parak said she takes into account when making a decision on the repo rate. Her view is therefore that changes in monetary policy should be made gradually, which reduces the risk of too many errors.

It is not difficult to imagine that the recovery will be slower than is assumed in the forecast. But the opposite may also be the case. In both cases it will of course be necessary to adjust the forecasts and the repo-rate policy. But the way things have been going since February, Ms Wickman-Parak does not envisage any such need now. If the crisis in Europe were to escalate and economic activity were to suffer a serious setback, all of the forecasts would have to be reconsidered. Ms Wickman-Parak concluded by saying that the Riksbank would in this case be prepared to take action, which was clearly illustrated during the period with the large repo-rate cuts from 2008 onwards.

Governor **Stefan Ingves** stated that shares the assessment of the Swedish economy described in the draft Monetary Policy Update and that he supports the proposal to hold the repo rate unchanged at 1.5 per cent and to hold the repo-rate path unchanged.

GDP fell during the fourth quarter of last year and this was mainly due to falling exports. Indicators show that GDP growth will be higher in the coming period, but that growth during 2012 as a whole will be relatively weak. The National Institute of Economic Research's Economic Tendency Survey has taken a sharp upward turn and indicates that the Swedish economy has put the largest fall in growth behind it. Indicators point to exports rising once again, but weak conditions abroad mean that the upturn will be fairly limited. Domestic demand is also expected to be weak in the near future. Although households have become slightly more optimistic, a poorer labour market also contributes to households being more cautious than normal. The weak housing market will hold back housing investment in the coming period. However, the investment survey points to companies in the remainder of the business sector wishing to increase their investments somewhat this year. The picture of economic activity is thus fragmented, according to Mr Ingves, and it is difficult to see what direction the economy is taking.

As concerns over the European debt crisis are waning, Mr Ingves's assessment is that households and companies in Sweden and abroad will become increasingly optimistic. This will contribute to a gradual rise in GDP growth over the coming years. Resource utilisation in Sweden is expected to be lower than normal this year and next year, and to return to a normal level during the latter part of the forecast period. In addition, inflation is low when measured both in terms of the CPI and the CPIF. Low increases in labour costs and a stronger krona are some of the factors that have contributed to this. If we look ahead, CPI inflation will fall over the coming year, because the Riksbank's recent repo-rate cuts have a direct impact on the CPI. After that, inflation will rise and will stabilise just below 3 per cent with effect from early 2014. CPIF inflation will rise gradually over the coming years and stabilise around the inflation target from the end of 2013.

According to Mr Ingves, it is necessary to begin gradually raising the repo rate in the coming period to around 3 per cent at the beginning of 2015, so that resource utilisation can return to normal and inflation can return to the target. The Swedish economy has a good starting point, with strong public finances, a large current account surplus and modest wage increases. There is thus not the same need for low interest rates as in, for instance, the United States and the euro area, where they do not have the same good starting point. We appear to have roughly the same situation as before, where Sweden is between, for instance, southern Europe which needs to have a low interest rate, and several large, rapidly-growing countries, which need to have a much higher interest rate than Sweden.

Mr Ingves also pointed out that there is still considerable uncertainty, and that there are always risks around the main scenario. Renewed concerns over sovereign debt problems in Europe could delay the recovery abroad. The repo-rate path would then need to be lower than in the main scenario. If there were a more rapid recovery abroad or in Sweden, or if household debt in Sweden were to begin to rise again, this could on the other hand justify a higher repo-rate path. Given all this, Mr Ingves sees no need for monetary policy fine-tuning and the most appropriate course of action is to hold the repo rate unchanged.

Ms af Jochnick and Mr Jansson mentioned household indebtedness in their contributions to the discussion. Mr Ingves said that an overly rapid increase in household debt could be a problem in the long run. If the burden of debt becomes untenable, there may be an abrupt adjustment of households' balance sheets that gives rise to low growth. The IMF's most recent World Economic Outlook[14] shows that recessions preceded by a rapid increase in debt tend to be both deeper and more prolonged than recessions where there is a normal development in debt. Although such a conclusion does not really fit in with the short-term economic analysis, these risks should not be overlooked in such analyses. It is therefore important to also consider debts among both households and companies when formulating monetary policy. This is particularly important, according to Mr Ingves, in a situation where Sweden has not yet made it clear how questions of macroprudential policy will be managed, at the same time as new regulations are needed to deal with liquidity in the banks, capital adequacy and risk-weighting for mortgages. In addition, one should consider whether it may be necessary to introduce amortisation requirements for mortgages in addition to the loan ceiling.

There is currently a discussion on interest rate margins for variable-rate mortgages and to what extent these have significance for monetary policy. Mr Ingves said that changes in this interest rate margin have relatively minor effects on growth and inflation and thereby also on monetary policy. What is more important to monetary policy is the general interest rate level, which includes many different interest rates paid by both households and companies. Given all of the other assessments made in the forecast, the effects of changes in interest rate margins on variable-rate mortgages have minor significance for both the forecasts and monetary policy.

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[14] IMF (2012), Tensions from the Two-Speed Recovery: Unemployment, Commodities, and Capital Flows, *World Economic Outlook*, April 2012.

Mr Ingves concluded by commenting on Mr Svensson's contribution to the discussion regarding issues of principle. Mr Ingves stressed that the monetary policy conducted in 2011 is described in the Riksbank's report "Material for assessing monetary policy 2011". During the production of this report, many of the questions Mr Svensson now took up at the monetary policy meeting were discussed. Mr Ingves therefore said that there was no reason to go into these issues again. However, he concluded by commenting on the use of the size of the mean squared gap as guidance for the monetary policy decision. The majority opinion among the Executive Board members is that such a measure is not desirable, as it narrows the discussion of monetary policy too much.

Deputy Governor **Lars E.O. Svensson** then referred to Mr Jansson's and Mr Ingves' discussions of household debt. In his comments, Mr Ingves referred to the chapter on indebtedness in a number of countries in the IMF's World Economic Outlook. Mr Svensson claimed that the analysis in this chapter is somewhat superficial – there is no analysis of the reasons for the increase in the level of debt and the differences between the various countries. Whether or not indebtedness is a problem in a particular country depends on a number of factors that are not discussed in the chapter, according to Mr Svensson. There is, for example, no discussion of the sustainability of the level of debt and of the overall economic and financial situation of the households. Nor is there any discussion of the reasons for the increase in debt. For instance, it is not discussed whether, as in Sweden at the moment, this is due to increases in the prices of assets and housing based on fundamentals where the quality of credit assessment and the debt servicing ability of the households has been retained at the same time as there are no signs of an unsustainable boom in the economy or the housing sector.

Mr Svensson pointed out that it is his firm view that one should definitely not use monetary policy in Sweden to try to control housing prices and mortgage growth. He said that there is considerable support for this view.

Finansinspektionen's report on the Swedish mortgage market from March this year, which Ms af Jochnick referred to earlier, provides such support, Mr Svensson maintained.[15] This report notes that the situation is even more stable than two years ago, when the previous report was published in February 2010, and that the situation was already relatively stable then. The loan-to-value ratio for new loans is lower, the debt servicing ability of the borrowers is high, credit assessment is thorough, loan requirements have been tightened up, the borrowers pass stringent stress tests and the loan-to-value ceiling is to all appearances an effective instrument. Mr Svensson said that all-in-all the report shows that mortgages do not constitute a threat to financial stability.

[15] Finansinspektionen (2012), *Den svenska bolånemarknaden (The Swedish mortgage market)*, Report 13 March 2012.

A study by Claussen, Jonsson and Lagerwall (2011) in the Riksbank's inquiry into risks on the Swedish housing market also provides such support.[16] This study shows that there are no signs of a housing bubble. The increase in housing prices since the mid-1990s is explained by increased disposable incomes, lower real mortgage rates and an increased preference for housing consumption. It also shows that monetary policy has limited effects on housing prices and that using the policy rate to influence housing prices (and thus mortgage growth) entails significant costs to the real economy. Using monetary policy to prevent increases in housing prices would have been very costly in terms of both production and inflation. Holding housing prices to a long-term trend from 2004-2010 would have required repo-rate increases over several years by up to 5 percentage points in both 2006 and 2007 and have led to a level of GDP growth that was on average almost 2 percentage points lower up to 2010. This corresponds to an accumulated GDP loss of approximately 12 per cent. CPIF inflation would have been on average 3 percentage points lower during the same period.

Using monetary policy to influence housing prices and to hold them to their trend thus entails seriously neglecting both the price stability target and the aim of achieving a high level of employment, according to Mr Svensson. The study confirms for Sweden, too, what several other international studies have concluded.[17] Monetary policy should not be used to influence the development of housing prices (and thereby mortgages). Mr Svensson pointed out that there are much better instruments, such as the loan-to-value ceiling, if one wants to influence housing prices and mortgages.

The study also shows that the macroeconomic effects of a 20 per cent fall in housing prices would be relatively limited and possible to counteract by adopting a more expansionary monetary policy. This is shown in more detail in the minutes of the monetary policy meeting held in July 2010, when Mr Svensson presented simulations of how expansionary monetary policy can stabilise CPIF inflation and GDP growth following such a fall in housing prices.

With regard to Mr Jansson's comments on the downward-sloping long-run Phillips curve for Sweden, Mr Svensson said that all he has done so far is to establish facts. The fact that CPIF inflation has on average undershot the inflation target and inflation expectations, according to Prospera, by 0.6 percentage points over the last 16 years would appear, according to data and to Mr Svensson's calculations, to have entailed unemployment being an average of 0.8 percentage points higher during the same period. Mr Svensson also emphasised that he has not said anything about the reasons why CPIF inflation has

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[16] Claussen, Carl Andreas, Jonsson, Magnus and Lagerwall, Björn (2011), "A macroeconomic analysis of housing prices in Sweden", *The Riksbank's commission of inquiry into risks on the Swedish housing market*, April 2011, pages. 67–95.

[17] Se for example Assenmacher-Wesche, Katrin, and Stefan Gerlach (2010), "Monetary policy and financial imbalances: Facts and fiction", *Economic Policy*, July 2010, 439-482.

been so low and that inflation expectations according to the Prospera survey have nevertheless been anchored around the inflation target. These give rise to interesting and important questions that Mr Svensson considered require investigation. Could decision-makers at the Riksbank have seen the inflation target as a ceiling rather than a central point? Have they simply not been concerned about unemployment? Could it be the case that the low rate of inflation is explained by surprisingly negative "cost push" shocks (cost shocks for the given unemployment gap)? Mr Svensson questioned whether it was reasonable that such shocks could have caused negative surprises for a good 16 years. One can also note that inflation has on average been much closer to the target in other countries that conduct inflation targeting, such as Canada and the United Kingdom. Mr Svensson concluded by repeating that this raises important questions that should be investigated carefully, as the implications of these facts may be so far-reaching.

Deputy Governor **Karolina Ekholm** commented on two previous contributions to the discussion. First she referred to Mr Svensson's remark that the average rate of inflation has been below the target. Ms Ekholm said that she agreed with Mr Jansson that it seems strange to think that the Riksbank would have systematically chosen to deviate from a target that it has itself set. She noted, however, that there may be tendencies in the decision-making process itself that have led to such an outcome. Throughout her period on the Executive Board there has been a tendency to be content with simply getting back to the target towards the end of the forecast period in situations when inflation has fallen below the target. However, she pointed out that she does not know what the situation regarding this has been in the past. But if it is the case that the shocks to the economy have mainly tended to push down inflation (for example in the form of the negative "cost push" shocks referred to by Mr Svensson), and decision-making has been conducted in the way she has described, then Ms Ekholm believed that this may have led to a bias towards falling below the inflation target. She pointed out that this is something to which she has attached a certain amount of importance when advocating a more substantial repo rate cut in order to bring inflation up a little more quickly towards the target.

Second, Ms Ekholm referred to Mr Ingves's comments that one should not devote time and energy to fine-tuning monetary policy, as she believed that her discussion of which forecast may be most appropriate for the repo rate three years ahead is an obvious example of such fine-tuning. Ms Ekholm explained that as far as she was concerned it was important to do one's best to achieve good target attainment, that is, to advocate the monetary policy that is associated with the best possible forecast for inflation and resource utilisation. Advocating any other monetary policy can only be justified if one believes the policy that entails the best possible forecast for inflation and resource utilisation will have other consequences that one wants to avoid. However, Ms Ekholm believed that if this is the reason for wanting a different monetary policy then it should be stated explicitly. In this context she referred to Mr Ingves's comment that there are as yet no regulations for macroprudential policy in place in Sweden and that the Executive Board should therefore take into account factors that are important to financial stability when deciding on monetary policy. Ms Ekholm said that this sounds like a reasonable point of view, but she pointed out that the Riksbank is the only body that has responsibility for the policy that focuses solely on cyclical stabilisation. Responsibility for maintaining financial stability, on the other hand, is shared between the Riksbank and other bodies. The fact that the Riksbank has sole responsibility for cyclical stabilisation is particularly clear now when it appears that discretionary fiscal policy will, if anything, be procyclical rather than countercyclical. Ms Ekholm believed that it was important for monetary policy to focus on the traditional objectives of stabilising inflation around the inflation target and resource utilisation around a sustainable level because no other body works towards these objectives.

Deputy Governor **Per Jansson** referred to the discussion of household indebtedness and the conduct of monetary policy. He clarified that his present assessment of an appropriate monetary policy is not directly related to the development of household indebtedness. He emphasised that this was an aspect of importance on the margin in his decision, a positive by-product if you like.

On a general level, Mr Jansson said that the role of monetary policy with regard to indebtedness and other factors that may affect financial stability depends on the situation at hand. If, for example, macroprudential policy is working well and is effective, then it is probable that monetary policy can play a more passive role. But if, on the other hand, macroprudential policy is not working well and is ineffective, then it is probable that monetary policy must shoulder a greater responsibility.

Mr Jansson said that he found it hard to believe that monetary policy will not play any role at all in this context in the future. In conclusion, Mr Jansson pointed out that the view that monetary policy should sometimes take into account different aspects that may affect financial stability is in line with the conceptual framework that Michael Woodford has advocated in an article in the Riksbank's journal, *Sveriges Riksbank Economic Review*.[18]

With regard to the discussion of financial stability and monetary policy, Deputy Governor **Barbro Wickman-Parak** commented that no-one can deny that the interest rate has an impact on the demand for loans. Macroprudential policy instruments will eventually be introduced and Ms Wickman-Parak said that the desirable mix between interest rates and these tools will depend on the situation.

[18] Woodford, Michael (2012), "Inflation Targeting and Financial Stability". *Sveriges Riksbank Economic Review* 2012:1, pages 7-32.

Deputy Governor **Lars E.O. Svensson** pointed out, with regard to the comments on macroprudential policy by Mr Ingves and Mr Jansson, that Sweden already has instruments that affect leverage and loan-to-value ratios in the financial and household sectors that are much better than the policy rate. The banks' leverage is directly affected by the capital requirements, which have recently been tightened. If necessary, they can be tightened more. The mortgage loan-to-value ratio is directly affected by the loan-to-value ceiling, which according to Finansinspektionen's mortgage market report has been rather effective. If necessary the loan-to-value ceiling can be lowered further. There is no shortage of instruments that are better than the policy rate, Mr Svensson maintained.

With regard to Mr Jansson's reference to the article by Michael Woodford in *Sveriges Riksbank Economic Review*, Mr Svensson pointed out that Woodford assumes that there are no instruments that directly affect leverage. If one instead assumes that there are such instruments, as is in fact the case in Sweden, then monetary policy and macroprudential policy can without problems be conducted independently. This is shown in Mr Svensson's own comments in *Sveriges Riksbank Economic Review* on Michael Woodford's article.[19]

Deputy Governor **Kerstin af Jochnick** clarified that her previous comments on household indebtedness were not primarily an argument for the monetary policy decision. However, she pointed out that it is important that an assessment of the appropriate monetary policy also includes the possible development of imbalances resulting from a long period of low interest rates. A household sector with a high level of debt will, for instance, have less scope for consumption in a situation with higher interest rates. This in turn has an effect on domestic demand. The question of macroeconomic imbalances should be analysed and of course belongs to the field of macroprudential policy. While awaiting a clearer allocation of responsibility on the issue of macroprudential policy and tools for this, it is natural that the Riksbank should discuss these issues.

The Chairman, Governor **Stefan Ingves,** observed finally that there was agreement that growth in Sweden will be weak this year and will then improve. On the other hand, there are differing opinions as to how expansionary monetary policy in Sweden needs to be to stabilise inflation and resource utilisation. Two members advocate, for similar reasons, cutting the repo rate by 0.5 percentage points and having a lower repo-rate path than that described in the most recent Monetary Policy Report. However, the majority of members support the proposed repo-rate path and holding the repo rate unchanged at 1.5 per cent.

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[19] Svensson, Lars E.O. (2012), Comment on Michael Woodford, "Inflation Targeting and Financial Stability". *Sveriges Riksbank Economic Review* 2012:1, pages 33-39.

§4. Monetary policy decision

The Executive Board decided after voting

- to adopt the Monetary Policy Update according to the proposal, Annex A to the minutes,
- to publish the Monetary Policy Update on Wednesday, 18 April 2012, at 9.30 a.m.,
- to hold the repo rate unchanged at 1.5 per cent and that this decision would apply with effect from 25 April 2012,
- to publish the decision above at 9.30 a.m. on Tuesday 18 April 2012 with the motivation and wording contained in a press release, and
- to publish the minutes of today's meeting on Wednesday 2 May 2012 at 9.30 a.m.

Deputy Governors Karolina Ekholm and Lars E.O. Svensson entered a reservation against the decision to hold the repo rate unchanged and against the repo-rate path in the Monetary Policy Update. They preferred both lowering the repo rate to 1.0 per cent and a lower repo-rate path than that in the Monetary Policy Update.

Karolina Ekholm preferred a repo-rate path that stays at 1 per cent to the third quarter of 2013, and then rises to 2.25 per cent by the end of the forecast period. This was justified by her assessment that a repo-rate path that is associated with a higher forecast of CPIF inflation and a lower forecast of unemployment constitutes a better-balanced monetary policy.

Lars E.O. Svensson preferred a repo-rate path that stays at 0.75 per cent from the third quarter of 2012 through the third quarter of 2013, and then rises to 2 per cent by the end of the forecast period. This was justified by his assessment that the Update's forecasts of foreign policy rates further ahead and euro area growth are too high and that his repo-rate path is associated with a forecast of CPIF inflation that is closer to the inflation target and a forecast of unemployment that is closer to a long-run sustainable rate and therefore constitutes a better-balanced monetary policy.

This paragraph was verified immediately.

Minutes by

Ann-Christine Högberg

Verified by:

Karolina Ekholm	Stefan Ingves	Per Jansson
Kerstin af Jochnick	Lars E.O. Svensson	Barbro Wickman-Parak