



# Time to improve the inflation target?

Handelsbanken  
3 December

Deputy Governor Per Jansson

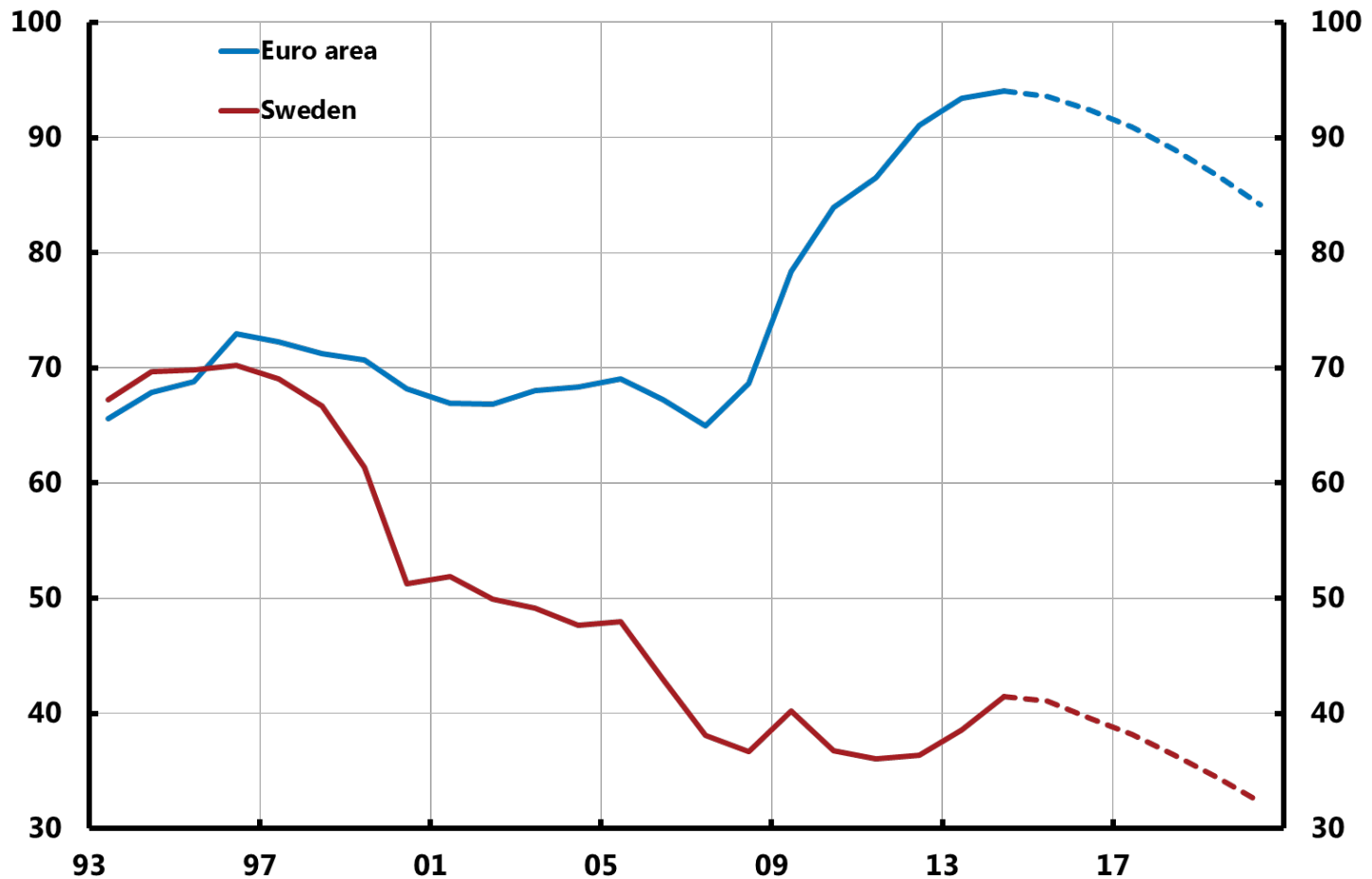
# My messages

- Be careful about making major changes to Swedish economic policy frameworks!
  
  - Flexible inflation targeting policy should also be the basis in the future
  
  - Some improvements are worth seriously considering, however
    - The target variable
    - Interval surrounding the target
-

# Reforms after the 1990s crisis provided stability

- The Lindbeck Commission 1993: "System failure"
    - Systematically overly expansionary economic policy
  - Fiscal policy
    - Framework with an amended budget process
  - Monetary policy
    - Inflation target, independent Riksbank
  - Wage formation
    - Industrial Agreement, industry plays normative role in wage formation
-

# Strong public finances fundamental

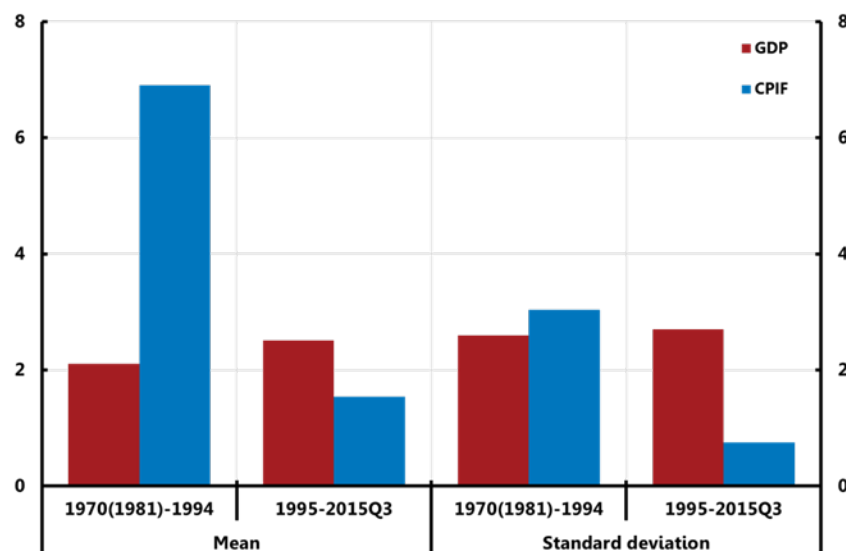


Note. Refers to public debt. The broken line represents the IMF's forecast.

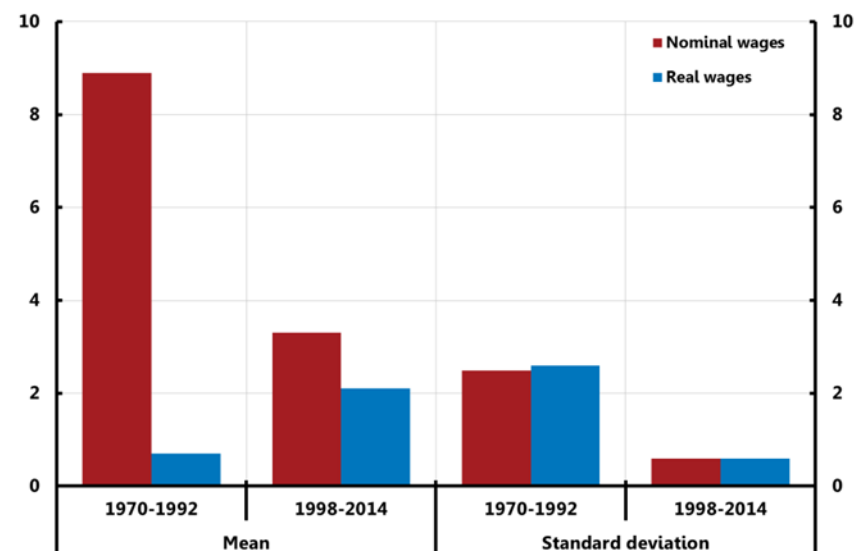
Source: The IMF

# Orderliness and reliability in the nominal economy

## Inflation and GDP growth



## Nominal and real wage increases



Note. CPIF refers to the period 1981–1994. Annual percentage change. According to short-term wage statistics after 1993 and wage structure statistics before 1993. Real wages are calculated as the difference between the annual percentage change in nominal wages and the annual percentage change in the CPI.

Sources: Swedish National Mediation Office, Statistics Sweden and the Riksbank

# High level of confidence in the Swedish economy internationally



Note. The yield differential refers to 10-year government bonds and is based on monthly data. Percentage points.

Sources: Thomson Reuters and the Riksbank

# Will *not* be raised

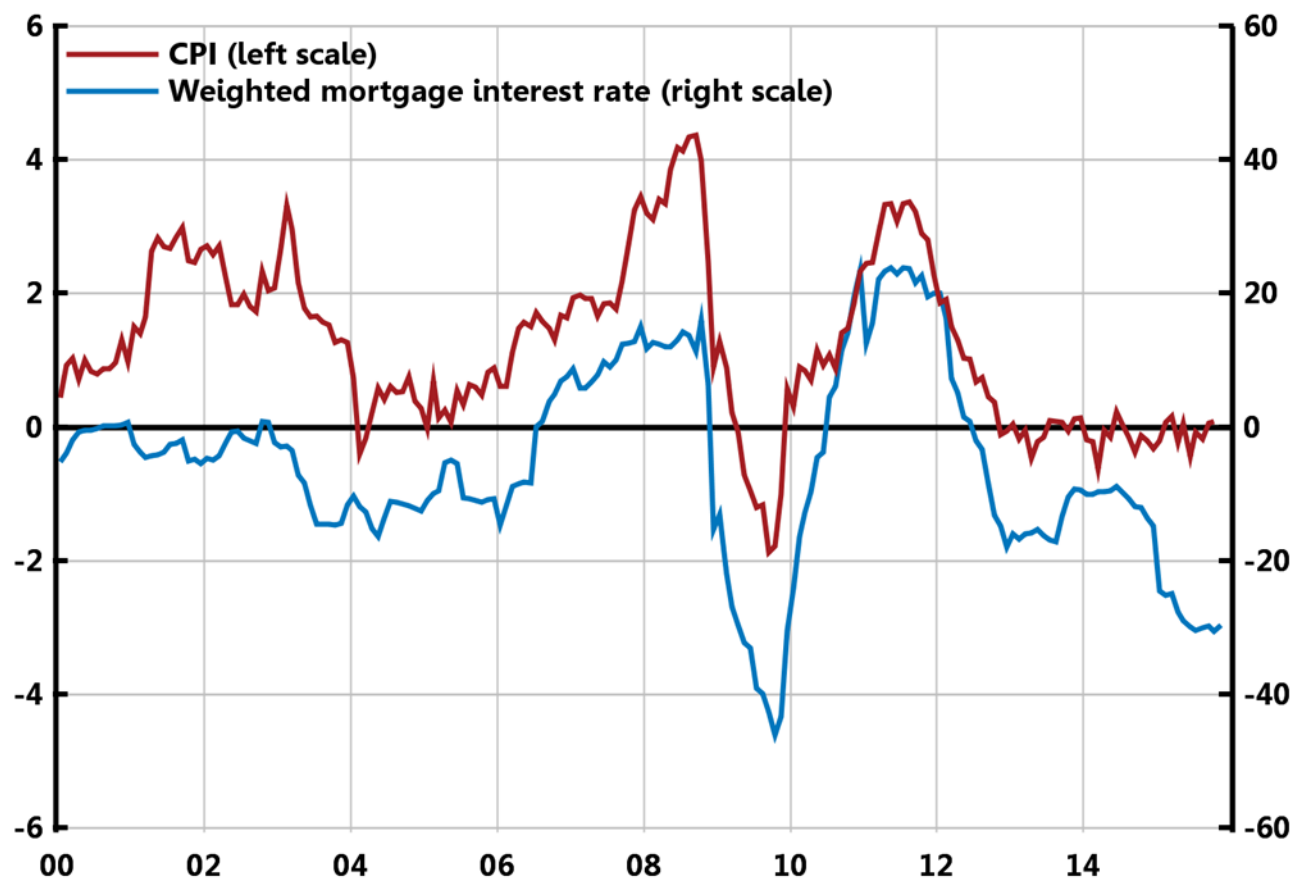
- Level of the inflation target
    - Recently discussed by Flodén and Skingsley, among others
  - Monetary policy and financial imbalances
  - Alternatives to inflation targeting (for ex. nominal GDP targeting)
  - Important however to follow the international debate!
    - Avoid home-grown solutions that we may regret
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# The target variable

- CPI from the beginning of 1993
    - Well-known measure
    - Large part of households' consumption
    - Published regularly
  - A problem, however: Major direct impact of interest rate changes in "the wrong direction"
  - Other measures have guided interest rate decisions:  
"On-target CPIF inflation on average leads to on-target CPI inflation"
-



# Interest rate changes have a direct impact on CPI inflation



Note. The weighted mortgage series rate is chained in December 2014 due to altered measurement method. Annual percentage change.

Sources: Statistics Sweden and the Riksbank

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  - A problem, however: Major direct impact of interest changes in "the wrong direction"
  - Other measures have guided interest rate decisions:  
"CPIF inflation of 2 per cent will lead to CPI inflation on target on average"
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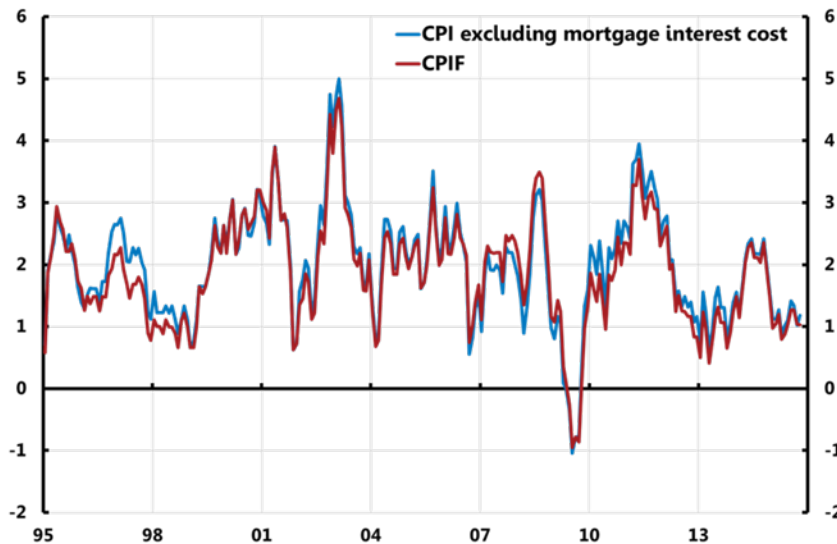
# Swedish CPI inflation relatively unique



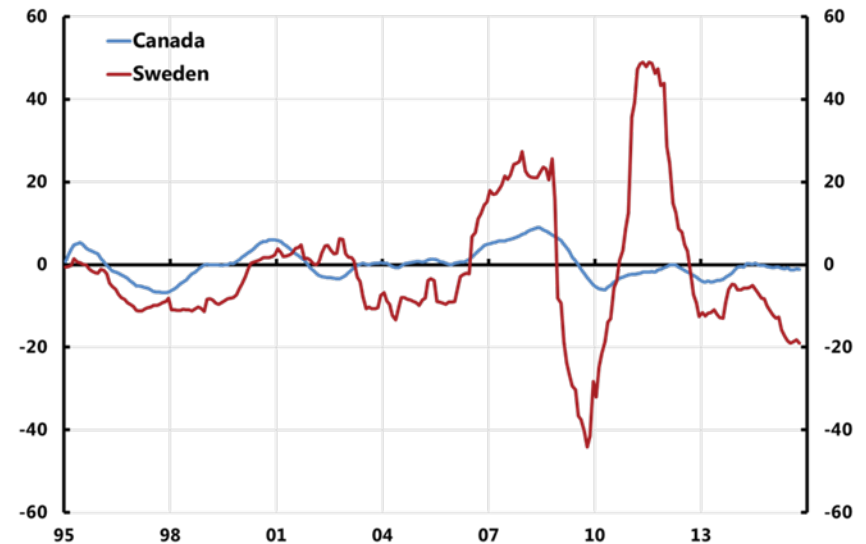
- Housing costs: Cost calculation in which interest rates weigh heavily
  - Less impact of interest rates in most other countries
    - USA, Norway - rental equivalent approach
    - Euro area, United Kingdom - HICP (operating costs only)
    - Australia, New Zealand - net acquisition approach
  - Canada has similar method to Sweden on paper, but...
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# Minor impact of interest rates on CPI inflation in Canada

## Inflation in Canada



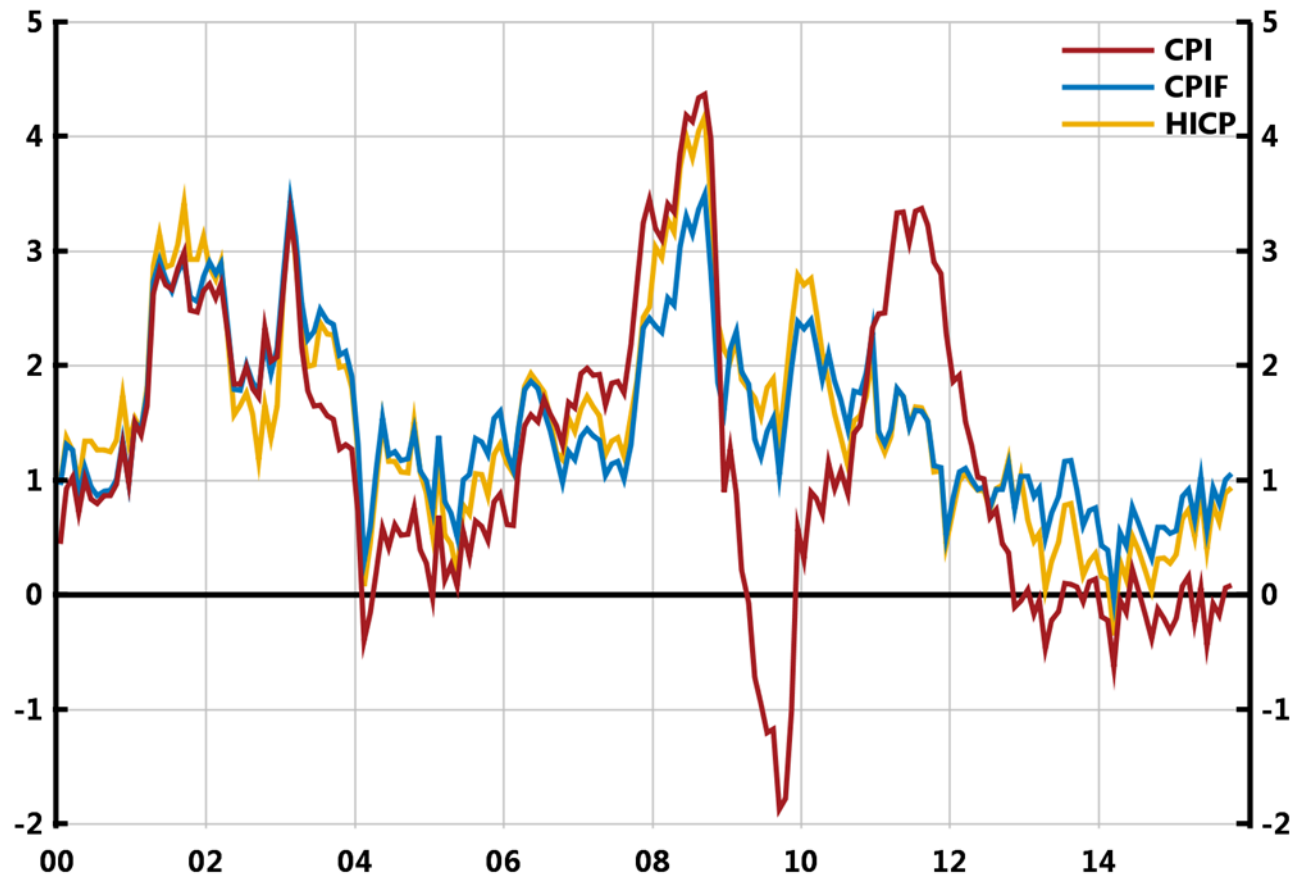
## Interest expenditure



Note. Annual percentage change.

Sources: Statistics Sweden and  
Statistics Canada

# Not a new phenomenon - but major differences since the crisis



Note. The CPIF is the CPI with a fixed mortgage rate. HICP refers to the EU-harmonised index for consumer prices. Annual percentage change.

Sources: Statistics Sweden and the Riksbank

# Problems with CPI as a target index

- Misleading image of state of the Swedish economy
  - CPI inflation has long been far from the target
    - Risk of reduced confidence in the inflation target
      - "Does stabilisation of CPIF inflation lead to stabilisation of CPI inflation?"
    - Risk of instability in terms of wage formation
      - Extremely low CPI inflation followed by unusually high CPI inflation
      - Major fluctuations in the focus on current CPI inflation
-

# "Deflation!"

NYHETER 07

## Deflation trots Riksbankens mål

Trots Riksbankens målförklaring att deflation i svensk ekonomi "det är svårt att se närheten" i november kommer upp till Riksbankens mål", säger Ole Holmgren på SEB.

Inflationstakten i november var -0,2 procent, enligt siffror från Statistiska centralbyrån (SCB). Det är en nedgång från oktober och ligger nära målet på 2 procent. Än så tidigt var prognosen i deflationstakten hos många av de större företagen i landet, chefsekonomyer på SEB.

– Det borde vara en viss lindring för deflationen. Men resultatet visar att många justera sig efter den och deflationstakten på sig har fallit under december, säger han.

Nästa vecka lämnar Riksbankens styrelse sin rapport för 2013. Enligt bankens senaste prognos för 2013, 2 procent under december, säger han.

– Det senaste året Sverige nådde att inflationen på 2 procent var 2013, med 2,8 procent inflation. I oktober i år nådde Riksbankens prognos nästan inget av detta fast på december och i upp deflationen. Anser att det är värt.

– Trots att vi har en svagare krona som trycker upp inflationen. Inflationen kommer att vara positiv i nästa år om inflationen kommer upp till Riksbankens mål, säger Ole Holmgren på SEB.

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SvD, December 2014

metro

PUBLISERAD 13 november 2013

## Deflationen kan tvinga riksbanken att sänka räntan

Sverige har deflation, i går kom nya siffror från SCB som visar att penningmängden minskar och priserna faller. Men personer med pengar på sparkontot eller stora lån kan tjäna på den negativa inflationen.

7 Bilder 041 0 [SKRIV ETT DEBATTSVAR](#)

Metro November 2013

## Deflation ny blåslampa på Riksbanken

Sverige har nu deflation, visar SCB:s senaste siffror. Konsumentpriserna sjönk med 0,2 procent från september till oktober. De oväntade siffrorna ökar förväntningarna på en räntesänkning från Riksbanken. (TT)

TT/SvD, November 2013

sverigesradio

Englände Sverberik  
1925-2013

nyheter Program P1 P2 P3 P4 Stockholms (SRT) Alla kanaler Sport Värmland

## Deflationen biter sig fast i svensk ekonomi

Publicerat idag 12 nov 2013 kl 18:38

[Fyra månader med deflation](#)  
0:22 min

Foto: Christian Olsson/Scanpix

Det fortsätter att vara lågt inflationstryck i svensk ekonomi, enligt nya siffror från Statistiska centralbyrån. I februari nådde inflationen inte ens upp till nollstrecket.

SR March 2013

affärsvärlden

AFGX 19.53  
-0,41%  
1 år +9,53%

Dow Jones 98.47  
+0,51%  
1 år +0,90%

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Nyhetsdygnet Aktieanalyser Affärsjuridik Kronikor Sily Season B

Stefan Ingves. Foto: TT

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## Större deflation än väntat

Av SIX Affärsvärlden  
Publicerad 14 juli 2015 09:40

Inflationstakten hamnade på minus 0,4 procent i juni, vilket är en nedgång jämfört med föregående månad.

SIX/Affärsvärlden juli 2015

Sweden

## Sweden slides further into deflation

Consumer prices fell 0.4% in September

16 shares

OCTOBER 14, 2013 by Richard Milne, Nordic Correspondent

Sweden experienced its 16th month of deflation in the past two years in September, raising the prospect of another interest rate cut later this month.

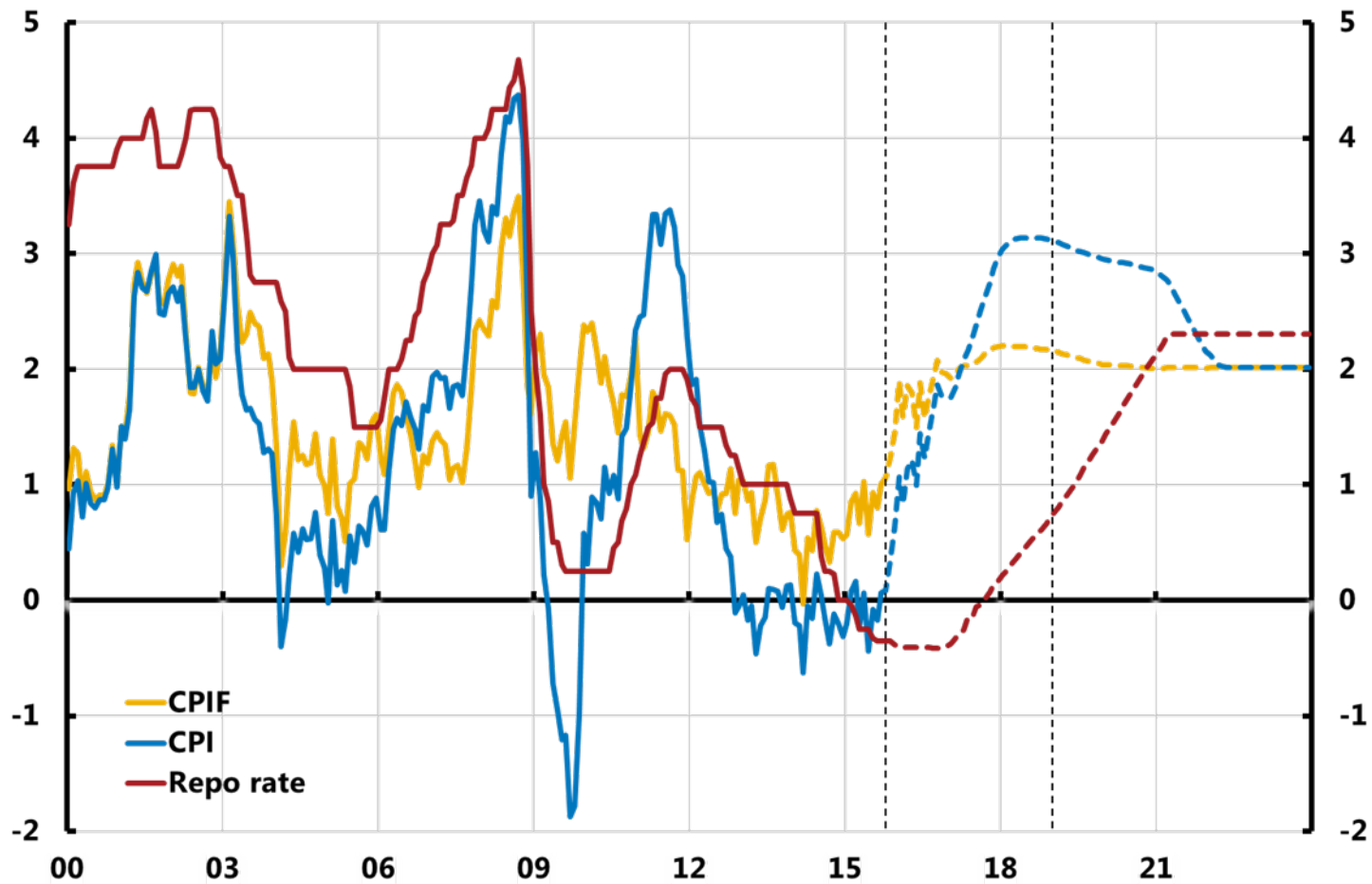
Financial Times October 2014

# Problems with CPI as a target index

- Misleading image of state of the Swedish economy
  - CPI inflation far from the target for a long time
    - Risk of reduced confidence in the inflation target
      - "Does stabilisation of CPI inflation really lead to stabilisation of CPI inflation?"
    - Risk of instability in wage formation
      - Extremely low CPI inflation followed by unusually high CPI inflation
      - Problems with major focus on current CPI inflation
-



# CPI inflation in the future - an example



Note. The CPIIF is the CPI with a fixed mortgage rate. The development of the CPI after 2018 is calculated based on a linear projection of the repo rate to its average between 1998-2015 and the assumption that the CPIIF will be at 2 percent.

Sources: Statistics Sweden and the Riksbank

# Interval surrounding the target

- Tolerance band  $\pm 1$  percentage point introduced at the same time as the target in 1993
- Removed in 2010
  - No practical function, "major deviations natural part of monetary policy"
- Sufficiently long time to evaluate the removal
  - Did the band really not fulfil any function?

# Tolerance band or target range?

- Tolerance band: 2 per cent point target, but 1-3 per cent can be "tolerated" in the event of unforeseen events
  - Target range: 1 or 3 per cent as good as 2 per cent
  - The Swedish debate is mainly about the target range: "The Riksbank does not need to aim for 2 per cent, risks linked to a very expansionary policy can be avoided"
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## Current Swedish debate about the range

- Monetary policy not rigidly fixated on 2 per cent
  - Rather: Long period below the target, falling long-term inflation expectations
  - Difficult to counteract future recessions if expectations get stuck at a level that is too low
    - See international debate on raising the inflation target
  - Neither a target range nor tolerance band would have led to a notably different monetary policy
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# Reasons to reintroduce the band

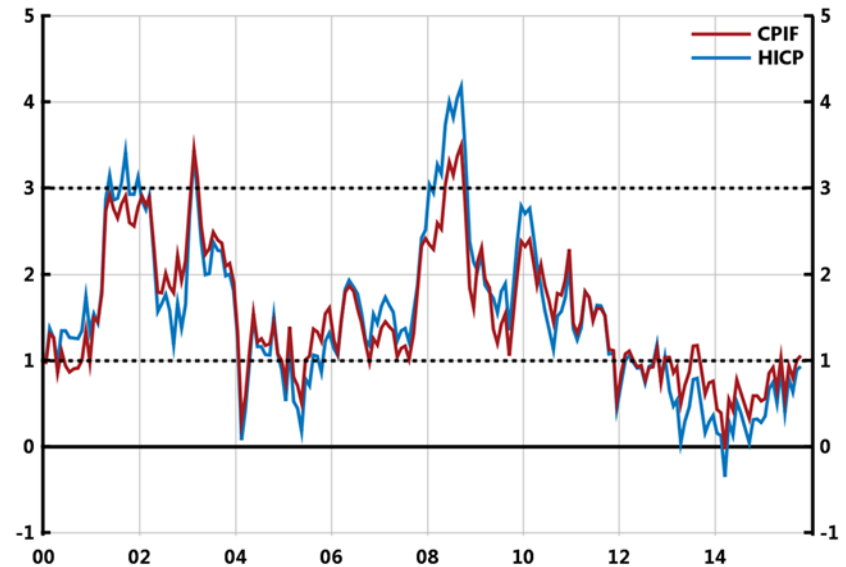
- Tolerance band useful for illustrating uncertainty surrounding monetary policy and reminding people that the Riksbank cannot fine-tune the economy and inflation
  - Band should have a practical significance
    - Special report (see Bank of England's open letter)
  - Important to match the target variable and the band
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# Tolerance band of 1-3 per cent would have been better suited to CPIIF and HICP

## CPI



## CPIIF and HICP



Note. The CPIIF is the CPI with a fixed mortgage rate. HICP refers to the EU-harmonised index for consumer prices. Broken lines refer to potential tolerance band. Annual percentage change.

Source: Statistics Sweden

# Time to improve the inflation target?

- Be careful about making major changes to Swedish economic policy frameworks!
  - Flexible inflation targeting also best approach in the future
  - Some improvements should be seriously considered, however
    - The target variable: Replace CPI inflation with CPIF or HICP inflation
    - Band: Reintroduce a tolerance band
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