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CONTACT Tomas Lundberg, Press Officer, tel. +46-8-787 02 15

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

## ■ High unemployment not due to monetary policy

*Deputy Governor Villy Bergström spoke today at a seminar on economics organised by TCO in Stockholm.*

"It is important to focus on the fundamental issues in the debate on employment. Today, open unemployment of 4 per cent, that is, the level the Government has set as its target, is regarded as full employment, while during the 1960s it was considered obvious that unemployment could be around 2-3 per cent. It should be just as obvious that unemployment can one day return to those low figures. However, monetary policy cannot influence this as there is no long-term stable connection between inflation and unemployment. Instead, structural measures are required to reduce unemployment in the long term. In particular, efficient labour market policy," began Mr Bergström.

"Inflation is at present even further below target than we anticipated at the beginning of 2003. This is largely due to high productivity and falling import prices – factors that are actually good for the Swedish economy. This shows that the Riksbank does not always forecast inflation accurately. However, if we look back in time 1 or 2 years, when the decisions affecting inflation now were taken, there were few who predicted that low international price trends and high productivity growth would so forcefully keep down inflation and job growth," said Mr Bergström.

"The important thing is that the deviations from the inflation target are short-term deviations and even out over time. This has been the case since the inflation target was introduced in 1993. According to the inflation measure adjusted for the direct effects of our own interest rate decisions, UND1X, inflation has on average been just above 2 per cent a year. Of course, it is always possible to find periods where inflation has deviated from target according to one measure or another. But to use one of these periods as evidence that we are deliberately trying to deviate from the target is wrong. It is just as important to avoid being



■ above the target as to avoid being below. One of the points of having a clear, symmetrical inflation target is that we are assessed according to how well we meet our target – if we were to deliberately keep below the target we would undermine confidence in the Riksbank. The effects of monetary policy on employment do not constitute any permanent job gains or losses, but rather fluctuations, which offset one another over time. This is not the case with regard to the debate, which often appears to have a bias. As far as I know, no articles were written claiming we had created thousands of jobs when inflation was *above* the target in 2001-2003, but now that we are *below* the target, there appears to be heavy bidding in the debate pages as to how many jobs our interest rate decisions have cost Sweden,” commented Mr Bergström.

“The relationship between inflation and employment in the short term is not as simple as it sometimes appears. Take, for instance, the recent development in Sweden where employment shows weaker growth than during earlier periods with a similar upturn in GDP growth. This is largely due to the good productivity growth that enables companies to meet increased demand without needing to recruit new staff. The Riksbank can vary the interest rate to stabilise demand to some extent. However, we cannot govern whether companies will meet this demand by varying the number of employees they have or through increased productivity. As the reality is so complex, it requires considerable work to make accurate forecasts of inflation and employment. It is therefore misleading to use a simple calculation for the relationship between the number of jobs and monetary policy in the short term,” said Mr Bergström.

“The fact that the Riksbank's power to influence employment is both short-term and relatively limited is not inconsistent with our ability to keep inflation in check. This is normally achieved by affecting inflation expectations. The Riksbank uses small changes in interest rates as a signal that it is keeping a close eye on inflationary tendencies. As long as there is confidence in the Riksbank's monetary policy, it is sufficient in certain situations that we show we are vigilant with, for instance, a 25 base-point change. In addition, market participants know that powerful measures will follow if inflation expectations deviate too much from the Riksbank's target, or for too long. Inflation expectations are currently anchored around the target,” Mr Bergström pointed out.

“It is important that we move on in the debate. The weak employment growth is one of our largest problems. However, it cannot be solved by discussing the small fluctuations that stem from stabilisation policy. Instead I see structural changes, together with deficiencies in labour market policy and the functioning of the labour market, as important reasons behind the fact that growth in employment is slow, despite the substantial demand for products and services. This is reflected in particular in the large regional differences we can see in the labour market today,” concluded Mr Bergström.