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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

■ Continuing robust economic activity and low inflation

Deputy Governor Irma Rosenberg gave a speech on Thursday at a meeting organised by Handelsbanken about the work on developing monetary policy analysis and the current state of the economy.

"Let me begin by drawing your attention to an improvement in the monetary policy analysis work we will introduce in the next Inflation Report. In addition to our main scenario, we will report inflation forecasts where the forecast horizon is longer than previously and where we make the assumption that the repo rate will develop in line with implied forward rates, which reflect market expectations of future interest rate policy," said Ms Rosenberg.

"The new calculations will be reported as supplementary information, while the forecast in the main scenario will be made in the same way as before. Our hope is that the fuller information will make it easier to understand the Executive Board's reasoning in situations where, for instance, inflation is affected by temporary influences. Previously, we have sometimes adjusted our inflation measure for temporary influences that we do not wish to affect our monetary policy. By extending our forecast horizon, we can now demonstrate more clearly that these influences will wane and more easily justify our monetary policy stance," explained Ms Rosenberg.

"At the end of 2002-2003, when energy prices soared, we supplemented our analysis with an inflation measure that was adjusted for energy prices. This caused some analysts to believe that we had changed our inflation target and it led to a debate on which inflation measure was most relevant to monetary policy and on when energy prices would be included in this measure. I believe that it would have been clearer to analysts how we wished to manage energy price fluctuations if we had also shown the path of inflation in a slightly longer-term perspective, as we intend to do now," continued Ms Rosenberg.



■ "In addition, I want to point out that we will also be making forecasts using an alternative assumption for the repo rate. The assumption of an unchanged repo rate, which usually underpins our main scenario, illustrates how inflation will develop in relation to our target given current monetary policy, but it is not realistic of course if the market expects a fast adjustment of the rate. A rate assumption more closely aligned with market expectations makes it easier to compare our forecasts with those of other forecasters who do not normally assume a constant rate. It also gives parliament and external analysts better opportunities to assess our forecasts and the way we work," said Ms Rosenberg.

"The changes involve making it easier to understand the reasoning of the Executive Board and the Riksbank. They do not entail any difference in the way monetary policy is conducted. Let me also emphasise that an interest rate trend that follows forward rates should not be interpreted as the monetary policy line the Riksbank considers most probable," stressed Ms Rosenberg.

"When it comes to the current state of the economy, I believe that the outlook we set out in the December Inflation Report and at our monetary policy meeting in January still applies on the whole. This has also been the case for more than a year now; even though there has been some uncertainty over economic activity it has in fact continued to develop strongly. Developments since our monetary policy meeting in January do not provide any reason for making major revisions to our assessments. The forecast that the euro area will show slightly weaker growth than was expected in December still applies. Conditions for growth in Sweden remain good. The National Institute of Economic Research's business tendency survey in February does point to weaker order growth in manufacturing in recent months, but the order situation is good nevertheless and firms are optimistic about output growth in the period ahead. Construction activity is rising, and most service sectors show a positive outlook. The same is true of households, which are showing considerable confidence ahead of the coming year. All in all, this could mean that we need to make a slight upward revision to our short-term Swedish GDP forecast," continued Ms Rosenberg.

"Developments in the labour market remain fairly sluggish, although there are some signs of improvement. For instance, the number of new vacancies reported is continuing to improve and the number of redundancies is lower than it was one year ago. The fact that employment has been weak while GDP growth has been strong is due to the rapid growth in productivity. Firms have been able to manufacture more without needing to recruit new staff. However, if demand in the economy continues to increase as we have assumed, firms will need to increase their workforces. It is therefore probable that employment will show an increase during 2005," said Ms Rosenberg.

"Finally, I shall say a few words about monetary policy decision-making. High growth is causing a gradual rise in resource utilisation. Inflation is nonetheless expected to be lower than the target level of 2 per cent for a large part of the coming two-year period. Given this, it could be argued that the repo rate should be cut further. However, there are also reasons for not cutting the rate. The driving forces behind the low inflation rate, the rapid productivity growth and the



low imported inflation are supply factors that in themselves have a stimulatory effect on growth. Growth is already high and exceeds the long-term sustainable rate. In addition, monetary policy is expansionary at present, which contributes to a rapid increase in household borrowing and in house prices. Investment in the business sector also showed a clear upward turn last year and we are expecting it to continue increasing at a reasonable rate throughout the forecast period. Given this, my assessment has been and remains that demand does not require further stimulation from monetary policy. At the same time it is, as always, worth stressing that this assessment applies today and under the conditions that currently prevail. Were we to see clearly weaker economic activity, for example, the assessment could change," concluded Ms Rosenberg.