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■ Globalisation contributing to low inflation

Deputy Governor Kristina Persson today spoke at FöreningsSparbanken's annual conference on the subject of globalisation and Sweden's low inflation.

"Over the last decade or so inflation has gradually fallen, both in Sweden and globally. The main reason for this is a shift in monetary policy regime in an increasing number of countries, with independent central banks aiming to meet a price stability target. But the decline in inflation has also been facilitated by globalisation, which has resulted in increased competition from low-wage countries and put pressure on the old industrialised nations to increase productivity. This trend is being reinforced by the opportunities created by new information technology," began Ms Persson.

"The low inflation in Sweden today has surprised many forecasters, including the Riksbank. The explanation seems partly to be higher than expected productivity and unexpectedly low imported inflation. So the low inflation is due to positive supply shocks and not to the Riksbank tightening monetary policy and dampening demand," continued Ms Persson.

"The fact that prices of imported goods and services (excluding oil) have dropped more than anticipated partly reflects the appreciation of the krona in recent years. But there are also signs that increased globalisation and stiffer competition from low-wage countries such as China and India have had some bearing on the situation. Surveys indicate that consumers are more inclined to focus on the price of a good rather than its country of origin. That in turn makes it more difficult for companies to pass on cost increases to consumers, forcing them to rationalise operations if they want to maintain decent profit margins," said Ms Persson.

"It is difficult to judge what long-term significance China's and India's integration into the world economy will have for inflation developments in Sweden. On the one hand, the Chinese manufacturing sector for several years has helped push down the prices of a host of different industrial goods and consumer products in the world market, and India now seems to be adopting the same role in the service sector. The continued liberalisation of trade, most recently the lifting of the

EU's quotas on textiles and clothing, and global competition also suggest that this positive supply shock may lead to persistently low imported inflation in the years ahead. On the other hand it is important to remember that China's and India's participation in international trade will not only result in a sharp increase in the supply of cheap goods and services; these countries will also contribute with considerable demand for commodities, goods and services from the rest of the world. For example, when China's construction sector and car production last year was close to overheating, its commodity needs grew so large that the country had to import 4 per cent of the total global output of steel. That helped push up metal prices, which in turn had an impact on the producer prices for Swedish industry," said Ms Persson.

"There are indications that the increasingly globalised world economy in which we're living, characterised by the elimination of trade barriers, the deregulation of product and financial markets and the integration of more and more countries into international trade, has resulted in strong structural change in Sweden in recent years. At the same time as the traditional industrial sectors are able to produce more with fewer workers, it seems that some businesses in the service sector are creating jobs regardless of the state of the economy, as has been confirmed in surveys of companies' hiring plans. Service production now provides the biggest contribution to total GDP growth," said Ms Persson.

"Among other things this structural change means that companies are outsourcing production and jobs to other countries. Hardly a week goes by that we don't hear about new company decisions to outsource certain activities. The process is being driven in large measure by the prospect of considerable cost savings. Many published studies, however, have failed to find evidence that the situation will lead to higher unemployment and poorer economic growth in the country from which the production has been outsourced. On the contrary, the studies suggest that a better division of labour between countries will result in lower costs and productivity gains, which in turn will enable labour and investment in industrialised countries to focus on higher valued-added products," said Ms Persson.

"As a small open economy, Sweden has had much to gain from increased global integration, but the change process can often be demanding. In particular, problems can arise if it is difficult to set up new businesses and change jobs. So there has to be sufficient incentives for people to start companies, study and look for work outside their usual occupation instead of getting stuck in long-term unemployment. One key factor for Sweden's economic performance in the years ahead is that we succeed in meeting the demands for change and adjustment that globalisation and structural change place on both businesses and individuals," concluded Ms Persson.