



# PRESS RELEASE

DATE: 4 April 2005

NO: 23

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

## ■ Economic outlook broadly unchanged

Governor Lars Heikensten spoke at a meeting at the county administrative board in Luleå about current monetary policy.

"In the public debate on monetary policy it is easy to get the impression that the policy rate in Sweden is too high, that it is hampering economic activity and is the main reason for the weak employment growth. There is therefore reason to begin by pointing out that the interest rate in nominal terms is at a record-low level. We have to go back to the 1960s and 1970s to find short-term interest rates as low as today. Also in real terms, i.e. the nominal rate level minus inflation, interest rates are among the lowest we have seen in 20 years. So monetary policy is clearly expansionary. Furthermore, the Riksbank has communicated that there is no hurry to raise the repo rate. Coupled with new information about economic developments in recent months this has contributed to a fall in long-term market rates as well, and to a somewhat weaker exchange rate, changes that also act as a stimulus on the economy," began Mr Heikensten.

"The loose policy has had notable effects. Households have been increasing their debt levels for some time and there are now also signs of higher corporate borrowing. Investment and construction are growing and consumption also appears to be rising steadily," said Mr Heikensten.

"The Riksbank last published its view of economic and inflation prospects in the coming years on 15 March. Our assessment was that world economic growth had peaked, but that it nevertheless could be expected to remain firm. So the world economic situation is continuing to improve even though there are, as always, risks. A similar outlook was seen for Sweden, with somewhat lower output growth this year than last. But growth is nonetheless expected to be around three per cent a year, higher than what the economy is deemed capable of sustaining in the long run. The composition of demand was forecast to be notably different from last year. We foresaw a smaller contribution from foreign trade and an increasing one from primarily investment, but also from private consumption. Given such developments, with domestic demand anticipated to pick up, there was reason to expect that employment would also begin to increase. Despite the



■ continued strong economic performance, we forecast that inflation would be low, though rising. That assessment was based on assumptions of high domestic productivity growth and low global inflation. Adding to this was a number of more particular factors such as increased competition in the retail trade sector and abolished import quotas for textiles," explained Mr Heikensten.

"As many of you probably know we left the repo rate unchanged at 2 per cent even though inflation was forecast to be below the inflation target of 2 per cent for a large part of the coming two-year period. As is so often the case, this was not a straightforward decision. And so it is rather natural that it should be the subject of some discussion, especially now that there is a lively political debate in the public domain over employment and unemployment," said Mr Heikensten.

"It was not one factor but rather a combination of factors that lay behind the decision. We asked ourselves, for example, how meaningful it would be in the current situation, a good bit into the cyclical upswing, to attempt to drive up general demand further above the level we believe to be sustainable in the long term. The already low interest rates and an ample supply of liquidity also suggest that a lower policy rate would have a smaller effect than usual. That should be true in particular if households and firms were to realise that a possible rate cut may have to be reversed within a short period, a thought that is hardly far-fetched now that the global interest rate trend has rebounded. Moreover, the presently low rate of price increases is due to factors that have little to do with developments in demand and whose durability is uncertain. To fuel demand further in such a situation may have its risks. An additional factor is the build-up in household debt coupled with rapidly rising house prices. The primary problem here is not the potential implications for the banks. Rather, it is what might happen with the general level of demand in the period ahead if circumstances were to change. Even though none of these arguments by themselves would perhaps have been enough I think that when taken together they call for a certain amount of caution," said Mr Heikensten.

"Since we made our assessment there have been signs that the expansion in the export industry has been dampened. Among other things, the foreign trade statistics and the National Institute of Economic Research's latest business tendency survey indicate that manufacturing activity is beginning to slow. Meanwhile, the same survey suggests that the domestically-oriented sectors, such as construction, large parts of the trade sector and the private services sector are now seeing increasingly strong demand. There are also other signals that the increase in retail sales continues to be firm and that Swedish households have become more optimistic about the future. So, to sum up, it seems that our outlook for the economy, with a steady upswing and a shift towards domestic demand, is holding up well. The most recent data perhaps suggest that the slowdown in the export-oriented areas of the manufacturing sector may prove somewhat more pronounced than expected. At the same time, there are as before other risks that affect the conditions for monetary policy," said Mr Heikensten.



■ "In the heat of a discussion it is natural to develop arguments in favour of one's own position. The logic in the public debate tends also to be such that one becomes rooted to a certain position regardless of how things subsequently develop. I therefore feel that it is extra important in situations such as the present one to underline something that we at the Riksbank usually emphasise: we always keep an open mind and regularly assess the new information that we receive. In the Committee on Finance a few weeks ago I stressed that all claims that the Riksbank had closed the door on a particular course of action in the future were, as usual, misleading. That is still the case today," concluded Mr Heikensten.