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■ Monetary policy is not the solution to the unemployment problem

Deputy Governor Villy Bergström gave a speech on Thursday at Uppsala Chamber of Commerce's annual general meeting on the subject of the labour market and the role of monetary policy.

"The main reason why the situation in the labour market has not improved is probably that the Swedish labour market finds it difficult to meet the present demands for change. Several factors indicate that the problems are not due to insufficient demand or excessively tight monetary policy. Both fiscal policy and monetary policy in Sweden are expansionary. There is also a strong demand in the world market," said Villy Bergström.

"Given the economic situation, employment has shown unusually weak growth and unemployment is at a relatively high level, by Swedish standards. This, together with the fact that inflation is very low, has led some debaters to the conclusion that demand is insufficient and that this is due to excessively tight monetary policy. However, this is the wrong conclusion. The fact that inflation has been lower than expected is due to an even higher productivity growth, even greater competition in the retail trade and even lower import prices than the Riksbank and most other analysts had forecast. These are beneficial factors which do not reduce demand. At the same time, low interest rates have contributed to increased demand, unusually rapid growth in lending to households and rising asset prices. Companies have ample liquidity and thereby good scope for investment. However, companies are increasing production without employing more staff, which is made possible by the strong productivity growth. The existing labour force is being used more intensively and efficiently," said Mr Bergström.

"There are parallels here to what we have seen during previous years in the similarly IT-intensive United States, where employment has increased with a lag relative to the cyclical upswing. This is because employers have initially pushed their organisations to the limit and got the most out of their earlier heavy IT investment before resorting to new recruitment. Given the intensive global competition and considerable scope for outsourcing operations, the labour market is constantly undergoing change with new opportunities for rationalising organisations. Many people are moving from an increasingly labour-scarce manufacturing sector to a service sector that is also rationalising. Data show that few of the sectors cutting staff in an economic downswing begin re-employing when economic activity improves again. The



■ redundant employees are instead forced to move on to other occupations. The Swedish labour market appears to find it difficult to meet these structural changes. The major differences in unemployment between regions and between professions indicate that there is less mobility in the labour market than there could be and that few people are finding new job opportunities in new sectors or new locations," said Mr Bergström.

"At the same time, the labour market has been affected by changes both within the EU and in the world economy as a whole. Asia is showing rapid growth in production and exports and reduced trade barriers are increasing the degree of competition even in markets that were not previously exposed to competition. The emancipation of the countries in eastern and central Europe has dramatically increased access to labour for manufacturing in these countries and also in Sweden. So far the labour migration has been only a small, albeit growing, element in the Swedish labour market. However, the pressure from the labour supply from the new EU countries will increase. The amount of foreign labour entering the various sectors will depend on the initial wage differences. The new member states' wage levels are in the process of converging with Swedish wages in the long term, but it is dangerous to assume that neither wages nor employment in various sectors in Sweden will be affected. If we assume this, there is a risk that we will not be sufficiently willing to make changes and then unemployment will rise," pointed out Mr Bergström.

"The Swedish labour force is thus facing competition both directly from foreign labour coming here and indirectly through households and companies choosing to buy goods and now even services that are produced abroad. Phenomena such as offshoring and merchandising can also be linked to the relatively high labour costs in Sweden. They indicate that Swedish companies fare well in international competition, but to an increasing extent these are operations that do not require much labour, at least not in Sweden," said Mr Bergström.

"Different assessments have been made of how large a percentage of total unemployment is cyclical. Among those that venture to make more precise calculations, which in itself are a difficult venture, one tenth appears to be a fairly common estimate, although it may well be an overestimate. The next question is how much of the cyclical part of unemployment may be affected by monetary policy. The serious assessments I have seen usually come somewhere around one fifth, for the period currently under discussion. It is thus a gross overstatement when, in the present debate, the Riksbank's decision to lower or not lower the interest rate is presented as having momentous consequences for unemployment. That kind of statement is not compatible with any serious assessments or forecasts," said Mr Bergström.

On the whole, the reasons for the problems in the labour market have not included poor demand – on the contrary, lending has grown at a rapid pace and companies have ample liquidity – but rather been related to structural factors. The present low inflation rate is due to other reasons. Despite different assumptions regarding inflation and monetary policy, total unemployment is not expected to fall significantly, neither according to forecasts made by us nor those of other analysts. This would require attending to the structural problems in the labour market," concluded Mr Bergström.