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## ■ Rosenberg: Surprisingly weak growth dampening inflation outlook

Deputy Governor Irma Rosenberg spoke on Wednesday about the economic situation and current monetary policy at a meeting arranged by Handelsbanken.

"World economic performance in recent years has generally been very good. Growth has been high, which bolstered the Swedish economy last year through very strong demand for our exports. Stiffer international competition has helped bring about low global inflation, despite the sharp rise in oil prices. This has contributed to weak inflationary impulses from abroad in the past few years," began Ms Rosenberg.

"In our most recent Inflation Report in March, we forecast that economic activity abroad would enter a slower phase this year, partly on account of less expansionary economic policy. Economic growth was nevertheless expected to remain firm in the coming years. Our assessment was also that the recovery in the Swedish economy would continue, but that the rate of productivity growth would moderate somewhat. Exports were no longer expected to increase as fast, but instead we assumed that growth in domestic demand would be more robust," said Ms Rosenberg.

"At our monetary policy meeting in April, we noted that the international economic situation appeared more uncertain than before. Various indicators were providing a mixed picture of developments in the United States, while new data for the euro area were giving clearer indications of weaker-than-expected output growth. In Sweden, there was evidence that industrial activity and goods exports were not growing as strongly as projected. Indicators of domestic demand in Sweden, however, pointed to an increase roughly in line with the March forecast. But we still could not see any really clear signs of a turnaround in the Swedish labour market, and this contributed to a feeling of increased uncertainty over the strength of the Swedish economy," continued Ms Rosenberg.

"In the United States, there seems to have only been a temporary slowdown. It now appears again that economic growth there is continuing at a firm rate and that resource utilisation is on the rise," continued Ms Rosenberg.

■ "In the euro area, though, the performance seems to be turning out weaker than we expected in March. For Sweden, the moderation in the euro area entails slower export market growth overall, since such a large proportion of our exports go to the euro area countries. Low interest rate levels and a lowly valued krona partly offset the slackening in Swedish export market demand, but nonetheless there is reason to revise down the prospects for Swedish exports," said Ms Rosenberg.

"Now that the first outcomes have been released for the first quarter this year, we can also note that Swedish GDP growth at the start of the year turned out considerably lower than all the forecasts I have seen to date. Exports slackened surprisingly fast. But household consumption and public consumption, too, turned out weaker than anticipated. Fixed investment in the business sector, however, rose strongly, roughly in line with our previous forecast. Naturally, there is, as usual, some uncertainty given that the first preliminary picture of developments in the first quarter may be revised as new data are compiled and analysed. Nonetheless, I doubt very much, on the basis of what we know now, that 2005 will be able to be characterised as a year of increasing resource utilisation," said Ms Rosenberg.

"The difficulty now is to determine whether the fairly pronounced dampening of growth in the first quarter marks the beginning of a cyclical downturn or whether it instead is a temporary slowdown. So far, most indications point to the latter. To a large extent, the developments reflect a fall in output in the public sector, particularly in local governments. Output in the business sector was not as weak. There are also special circumstances that make it difficult to assess the underlying strength of demand developments in the first quarter. Demand has, in all likelihood, been influenced by calendar effects, i.e. differences in the number of public holidays and working days between the first quarters this year and last. The calendar differences have probably contributed to making above all private consumption and foreign trade look overly weak during the first quarter. Nevertheless, in my opinion the weak GDP outcome implies that the forecast for GDP growth this year has to be revised down fairly sharply. For 2006, however, the information we have today only points to a smaller downward revision. The financial position of the local government sector, households and companies has strengthened. That suggests that both private and public consumption as well as investment may grow relatively firmly in the years ahead. Labour market conditions are still weak, but the number of job vacancies is increasing and redundancies are falling, and so there are signs nevertheless that an improvement may be on the way," said Ms Rosenberg.

"Finally, allow me to say something about the backdrop for the coming monetary policy decision. At our April meeting we decided, as in March, to leave the repo rate unchanged at 2 per cent. At that time we faced a number of difficult considerations. Inflation was expected to undershoot the inflation target of 2 per cent for the greater part of the forecast period, partly owing to supply-side factors, but to be in line with the target a couple of years ahead. At the same time, we foresaw a rate of economic growth that was higher than what can be considered to be sustainable in the long run. That was expected to contribute to a pick-up in resource utilisation, with gradually mounting inflationary pressures as a result. Moreover, household borrowing and house prices had been rising sharply for several years, due in part to the already expansionary monetary stance. In our opinion, these factors together called for a certain amount of caution in the formulation of monetary policy," said Ms Rosenberg.



■ "So far this year, inflation has turned out slightly higher than we expected in March. That partly reflects a higher oil price but also the fact that some domestic prices have not fallen as estimated. This points to a somewhat higher inflation forecast in the near term. At the same time, given the weak growth at the beginning of the year, it is unlikely that resource utilisation has picked up but instead has fallen so far this year. Even if growth strengthens again in the coming years, which I think there is reason to expect, this suggests that resource utilisation will be lower throughout the forecast period than previously anticipated. As I see it, both cost pressures and price increases will thereby be weaker in the period ahead than we previously expected. All in all, this is likely to mean that inflation, despite picking up gradually, will be well below target both one and two years ahead. Although there are still risks associated with the rapid rise in household borrowing and house prices, household consumption demand will probably be lower, above all this year, than we expected in March. Against this background, I myself see scope for a more expansionary monetary policy. The extent of this scope will be decided by the Executive Board at our meeting next week," concluded Ms Rosenberg.