

## Forecasts to 2007 under the assumption that the repo rate is held constant for two years

**This box presents two-year forecasts for Swedish inflation and the real economy conditioned on the assumption that the repo rate is held constant at its current level for the next two years. In this alternative scenario, which implies a lower repo rate than in the main scenario, inflation rises faster than in the main scenario, especially in 2007.**

In this Inflation Report the forecasts in the main scenario are based on the assumption that the repo rate follows a path in line with implied forward rates. Prior Inflation Reports have used a different interest rate assumption, namely that the repo rate is held unchanged for two years. To facilitate a comparison with the Riksbank's previous forecasts this box provides forecasts for inflation and GDP conditioned on a constant interest rate assumption. When comparing with the forecasts in the previous Inflation Report, however, it is important to remember that the repo rate was lowered by 0.5 percentage points in June. The forecasts in Inflation Report 2005:2 were thus based on the assumption that the repo rate would be 2 per cent until June 2007, whereas the forecasts in this box assume that the repo rate will be 1.5 per cent until September 2007.

The forecasts in this box extend two years ahead, in contrast to the main scenario's three-year forecast horizon. In previous Inflation Reports, where the main scenario involved an assumption of a constant repo rate, the forecast horizon was two years. The reason for continuing with the shorter forecast horizon in this box is that the assumption of a constant repo rate becomes more difficult to apply the further ahead the forecasts extend; under normal circumstances a constant repo rate over as long a period as three years would be a highly unlikely outcome. This can cause technical problems in the forecasting models used by the Riksbank, but is, above all, very difficult to take into account in the expert assessments that are a central feature in the formulation of the final forecasts.

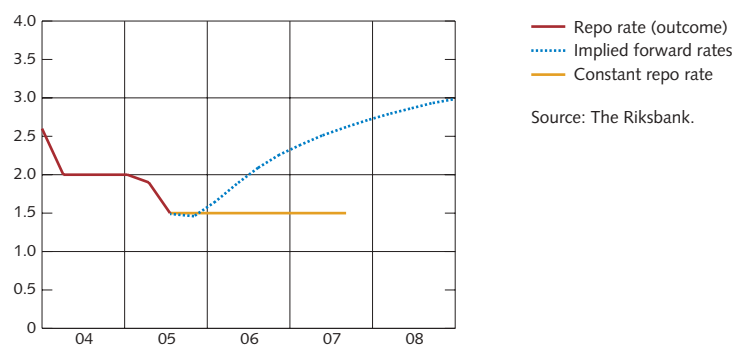
Figure B10 shows the difference between the interest rate assumptions in the main

scenario and in this box. The repo rate is kept on hold at 1.5 per cent until September 2007 instead of raising it as from spring 2006.

In the third quarter 2007 the repo rate in this alternative scenario is more than one percentage point lower than the main scenario's interest rate assumption.

The more expansionary monetary policy means that UND1X inflation rises faster than in the main scenario, due in part to a somewhat weaker exchange rate and higher economic growth. In the third quarters of 2006 and 2007, UND1X inflation is approximately 1.5 per cent and 2.1 per cent, respectively (see Table B5 and Figure B11). In CPI terms, short-term inflation developments are more subdued under a constant repo rate, in that mortgage interest expenditure, among other things, is lower with the constant repo rate (see Table B5). In the longer run, though, the constant repo rate means that the CPI forecast exceeds the corresponding forecast in the main scenario. Growth in investment, exports and consumption is somewhat stronger than in the main scenario, and GDP growth turns out higher in 2006 and 2007 (see Table B6).

**Figure B10. Repo rate assumptions: The main scenario's implied forward rate curve (15-day average as of 3 October 2005) and the alternative assumption of a constant repo rate.**  
Per cent



Source: The Riksbank.

**Table B5. Inflation forecasts under the assumption of a constant repo rate.  
Annual percentage change**

|       | Annual average |           |           | 12-month rate |           |           |
|-------|----------------|-----------|-----------|---------------|-----------|-----------|
|       | 2004           | 2005      | 2006      | Sept.-05      | Sept.-06  | Sept.-07  |
| CPI   | 0.4 (0.4)      | 0.5 (0.5) | 1.3 (1.5) | 0.6 (0.6)     | 1.3 (1.5) | 2.1 (2.2) |
| UND1X | 0.8 (0.8)      | 0.8 (0.8) | 1.5 (1.4) | 1.0 (1.0)     | 1.4 (1.2) | 2.1 (1.8) |

Note. The figures in parentheses are the forecasts in the main scenario. UND1X is CPI inflation excluding household mortgage interest expenditure and the effects of changes in indirect taxes and subsidies.

Sources: Statistics Sweden and the Riksbank.

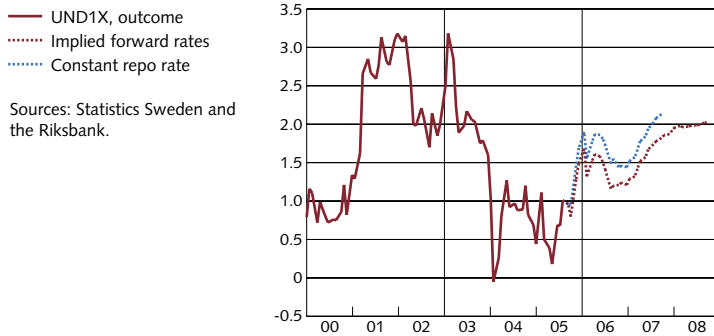
**Table B6. GDP growth: forecasts based on constant repo rate.  
Annual percentage change**

|                      | 2005      | 2006      | 2007      |
|----------------------|-----------|-----------|-----------|
| GDP at market prices | 2.3 (2.3) | 3.3 (3.0) | 2.8 (2.5) |

Note. The data refer to actual, non-calendar-adjusted, growth rates. The figures in parentheses are the forecasts in the main scenario.

Sources: Statistics Sweden and the Riksbank.

**Figure B11. UND1X: outcome and forecast up to September 2007 under the assumption of a constant repo rate and up to September 2008 under the assumption that the repo rate evolves in line with implied forward rates.  
Annual percentage change**



**Figure B12. CPI inflation: outcome and forecast up to September 2007 under the assumption of a constant repo rate and up to September 2008 under the assumption that the repo rate evolves in line with implied forward rates.  
Annual percentage change**

