



Monetary Policy Update

April 2008

At its meeting on 22 April, the Executive Board of the Riksbank decided to hold the repo rate unchanged at 4.25 per cent. Inflation is high while economic activity remains good, but there are signs of a slowdown. A repo rate of around 4.25 per cent over the coming year will contribute to bringing inflation back towards the target of 2 per cent a couple of years ahead and at the same time contribute to a balanced development in production and employment. However, there is still considerable uncertainty regarding the economic outlook and inflation prospects.

The Riksbank has the same view of the interest rate path as in February, which means that the repo rate is expected to remain at 4.25 per cent in 2008. As before, the Riksbank has to take into account different counteracting factors. On the one hand, inflation is still high, as are inflation expectations. On the other hand, the increasingly weak international economic activity will have an effect on Swedish growth and inflation.

Figure 1. Repo rate with uncertainty bands
Per cent, quarterly averages

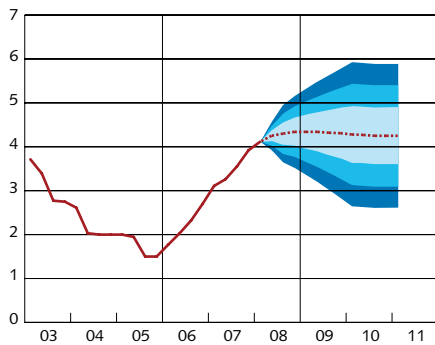


Figure 2. GDP with uncertainty bands
Annual percentage change, seasonally-adjusted data

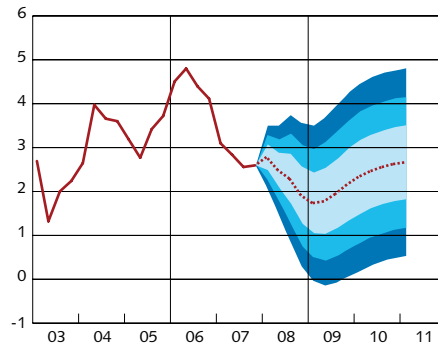


Figure 3. CPI with uncertainty bands
Annual percentage change

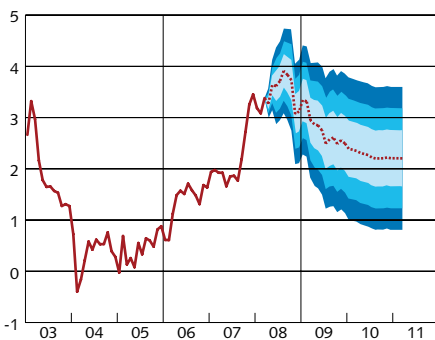
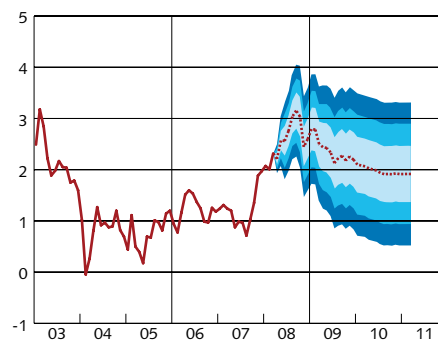


Figure 4. CPIX with uncertainty bands
Annual percentage change



— Outcome ■ 90%
 Forecast ■ 75%
 ■ 50%

Note. The uncertainty bands in figures 1-4 are based on historical forecast errors. See the in-depth article entitled "Calculation method for uncertainty bands" in MPR 2007:1. The CPIX (previously UND1X) is the CPI excluding household mortgage interest expenditure adjusted for direct effects of changed indirect taxes and subsidies.

Sources: Statistics Sweden and the Riksbank

■ New information since the February Monetary Policy Report

- The financial market turmoil has persisted since the Monetary Policy Report was published in February. The TED spread, the difference between the interbank rate and the treasury bill rate, has increased in the United States, the euro area, the United Kingdom and Sweden since the February Monetary Policy Report. For Sweden the continuing financial turmoil has meant that the interest rates at which Swedish households and companies mainly borrow have risen more than the 0.25 percentage points the repo rate was raised by in February. Stock markets have continued to be volatile since the Monetary Policy Report was published.
- In the United States expectations of future policy rates have been adjusted downwards but in both the euro area and Sweden they have been adjusted upwards, according to market pricing. Interest rates on government securities with a duration of up to 5 years remain more or less unchanged in the United States, but have risen in the euro area and in Sweden since February. Interest rates with a longer duration than 5 years have shown relatively little change in the United States, the euro area and Sweden.
- The dollar has continued to weaken against both the euro and the Swedish krona. In trade-weighted terms (the TCW index), the krona was marginally stronger during the first quarter compared with the forecast in February.
- The most recent outcomes and indicators point to weaker GDP growth in the world as a whole compared with the assessment in the most recent Monetary Policy Report.
- Recent statistics indicate that developments in the US economy are deteriorating further. The definite outcome for GDP growth during the fourth quarter of 2007 confirmed that growth was in line with the assessment in the February Monetary Policy Report, but at the beginning of the year household consumption had been unusually weak. Retail trade sales in March indicate continuing weak consumption growth. The slackening in the labour market has also been slightly more pronounced than expected. Employment in the United States fell in both February and March by around 80,000 jobs and unemployment has risen by 0.2 percentage points compared with January. Households have become increasingly pessimistic and indicators of their future prospects have fallen to an historically very low level. The US housing market is also continuing to slow down. Housing prices are continuing to fall according to the Case-Shiller index. Sales of new homes are still declining and the number of months that houses are up for sale has increased, according to the latest statistics.
- In the euro area, too, economic activity has been poorer than expected. GDP growth in the euro area amounted to 1.4 per cent calculated as an annual rate during the fourth quarter of 2007, which was in line with the assessment made in February. Industrial production in the euro area has continued to increase, while retail trade sales have fallen during the past three-month period compared with the previous three-month period. Various economic indicators for the euro area show that confidence among households and in the business sector has fallen. The largest downswing has been in the household sector.
- Inflation has been much higher than expected both in the United States and the euro area. In the United States CPI inflation was 4.0 per cent in March. Rising energy and food prices are the primary causes behind the higher inflation figures; when these items are excluded the CPI increased by 2.4 per cent in March. The so-called core inflation, measured against the private consumption deflator adjusted for energy and food, fell from 2.2 per cent in December to 2.0 per cent in January and February (the most recent outcome). HICP inflation in the euro area

was 3.6 per cent in March. Underlying inflation measured as the HICP excluding energy, food, alcohol and tobacco, was 2.0 per cent.

- The oil price has risen more than expected since the previous assessment. The price of Brent crude was almost 104 dollars on average in March. This was around 14 dollars higher than indicated by forward pricing at the beginning of February. The forward prices for delivery over the coming three years have risen since the Monetary Policy Report and are now more than 10 per cent higher for the entire forecast period.
- Electricity prices on Nordpool, on the other hand, have fallen since February and been lower than expected. The unusually mild winter is probably one important reason for this. In addition, forward prices indicate continuing low prices over the coming months. However, the forward pricing indicates roughly the same price level towards the end of the current year and onwards as in the previous forecast.
- Food prices are continuing to rise rapidly. According to The Economist's commodity-price index for food in the world market, the price increase was more than 40 per cent in March, expressed as an annual percentage change and translated into Swedish krona. In January the corresponding rate of increase was 23 per cent.
- Statistics Sweden's property price index for the fourth quarter of 2007 shows that the annual rate of price increase for single-family dwellings was around 11 per cent, which is unchanged compared with the previous quarter. Data for the first quarter of 2008 show that the annual rate of price increase on single-family dwellings had slackened to around 9 per cent, according to Statistics Sweden's index. According to estate agents' statistics prices of tenant-owned apartments have fallen during the whole of the autumn in all of the major cities and in Sweden as a whole, but in recent months prices have stabilised. In March tenant-owned apartment prices were 4 per cent higher than in March last year. The growth rate for lending to households fell somewhat in January and February compared with last year and is currently around 11 per cent when measured as an annual percentage change.
- In Sweden GDP growth was 2.8 per cent (seasonally-adjusted) during the fourth quarter of last year, compared with the corresponding quarter in the previous year. This was slightly stronger than predicted in February. Household consumption expenditure and fixed gross investment continued to show strong growth.
- The monthly statistics for exports indicate a recovery in exports of goods in recent months, compared with the relatively weak developments last year. The interpretation of the most recent purchasing managers' index is that industrial activity is continuing to rise. Although the National Institute of Economic Research's Economic Tendency Survey fell at the beginning of the year, the most recent survey shows some recovery in March. Household confidence indicators have fallen substantially in Sweden as in other parts of the world. Swedish households have primarily become more concerned over the situation and prospects for the Swedish economy, while the changes regarding their own finances are minor.
- In February employment rose by 95,000 persons or 2.1 per cent compared with February last year, and the percentage of persons unemployed, according to the EU definition, was 6.1 per cent (not seasonally-adjusted). The outcome was in line with the Riksbank's assessment in

February. Statistics up to the end of March show that the number of newly-registered vacancies has fallen significantly in recent months, but it remains high.

- The number of hours worked increased by 3.6 per cent (seasonally-adjusted) during the fourth quarter of last year, compared with the corresponding quarter in the previous year. This was a much stronger outcome than expected. The growth in the number of hours worked was higher than employment growth, which led to a large increase in the average hours worked. During the fourth quarter of 2007 the average hours worked per person in employment increased by 1.5 per cent compared with the corresponding quarter in the previous year. The increase in average hours worked per person employed in 2007 is mainly connected with a decline in absence, such as sick leave, but also to the fact that the average hours worked by people in employment has increased.
- Last year labour productivity throughout the economy fell by 0.7 per cent. The assessment in February was that productivity growth would show an upward swing during the final quarter of 2007 but instead it fell, which was mainly due to the surprisingly strong increase in the number of hours worked. Indicators for GDP and employment point to rising productivity growth during the first half of this year.
- Wages increased more slowly last year than the Riksbank had expected in the most recent Monetary Policy Report. According to the short-term wage statistics from the National Mediation Office, wages throughout the economy rose at a preliminary rate of 3.2 per cent. Together with retroactive wage payments, wages are expected to have increased by 3.4 per cent during 2007. Unit labour costs throughout the economy rose by 3.7 per cent last year, according to the National Accounts, which was lower than the assessment made in February. So far in 2008 the National Mediation Office has only published wage outcomes for the public sector. Wages in the local government sector have preliminarily showed an increase of 5.2 per cent in January, which was higher than expected and gives reason for an upward revision of the forecast for the rate of wage increase throughout the economy this year. The rate of wage increase in the local government sector is expected to be higher in 2008 but lower in 2009 than in the previous assessment, as a result of the way the central wage agreements are constructed.
- Households' inflation expectations were 2.6 per cent in March (for twelve months ahead) according to the National Institute of Economic Research's Consumer Tendency Survey, which is a decline of 0.4 percentage points compared with the previous month. Inflation expectations according to Prospera's survey show that expectations in April are marginally lower compared with the January survey. At one, two and five years ahead inflation is expected to be 2.9, 2.7 and 2.5 per cent respectively.
- The CPI and CPIX increased by 3.4 and 2.3 per cent respectively in March, when expressed as an annual percentage change. This outcome was in line with the February forecast, despite prices of oil products increasing more than expected. One important reason why inflation was not higher was that the effect of the annual revision of weights in the CPI was unusually large in January. The effect of this has earlier on average been -0.2 percentage points in the monthly change in January. This year the effect was -0.5 percentage points. This will affect inflation (the twelve-month change in CPI) throughout 2008. When adjusted for energy prices, inflation was unexpectedly low in March. The CPIX excluding energy increased by 2.0 per cent, which was around 0.2 percentage points lower than forecast.

■ The economic outlook and inflation prospects

The Riksbank's current picture of economic and inflation prospects is based on the assessment made in the Monetary Policy Report in February and the update to the forecasts presented in this Monetary Policy Update.

■ ■ Continued financial turmoil and increased interest rate spreads

The financial market turmoil has persisted since the monetary policy meeting in February. In Sweden this has contributed to both households' and companies' borrowing costs now being higher in relation to treasuries and the repo rate than was the case in February. The borrowing costs are also higher as the repo rate has been raised by 0.25 percentage points since February. The turmoil has probably also contributed to subduing households' and companies' optimism regarding the future.

■ ■ Economic situation in USA appears to be deteriorating

The most recently-received information indicates that economic activity in the US economy is deteriorating. Developments at the beginning of the year were weaker than expected. Price rises on for instance petrol and food have led to consumer prices currently increasing at an annual rate of 4 per cent, which undermines households' purchasing power. The fiscal policy stimulation which is expected to take effect in the autumn will contribute to some recovery in the economy during the second half of the year. The Federal Reserve's interest rate cuts together with the weaker dollar rate should also contribute to a recovery in both household consumption and exports. All in all, the forecasts for GDP growth in the United States are being revised down substantially both with regard to this year and next year, to 1.1 and 1.9 per cent respectively (see Table 4).

■ ■ Euro area economies affected by slowdown in USA

Developments in the euro area were slightly weaker than expected at the beginning of the year. Higher world market prices for oil and food have contributed to inflation being much higher than expected in the euro area. The weaker economic activity in the United States and a strong euro are expected to have a dampening effect on the economies in the euro area. The negative effects on households and companies of the financial turmoil in the form of increased interest spreads are also expected to subdue developments. Growth in the euro area is being revised down this year and next year (see Table 4). A recovery is not expected to take place until next year. All in all, the new assessment means that growth in the world economy will be slightly lower in 2008 and 2009 compared with the previous forecast, but that the slowdown will still be relatively mild.

■ ■ Gentle slowdown in Swedish economy

In 2007 GDP growth in Sweden was 2.6 per cent, which is close to the economy's average growth rate over the past 15 years. Both production and the number of hours worked increased slightly more than expected. Various growth indicators also point to a slightly stronger growth at the beginning of the year than was assessed in February. However, the poorer international growth prospects are expected to lead to growth in Sweden slowing down towards the end of this year and the beginning of next year. All in all, this will lead to GDP growth on the one hand being expected to be slightly higher in 2008 as a result of the good start to the year, but on the other hand to growth being slightly lower in 2009 than was forecast earlier.

In this forecast the Riksbank is assuming that the Swedish Government will increase expenditure and cut taxes slightly more than the Bank expected in February. This is expected to primarily affect developments in 2009 and 2010. The public sector financial balance as a percentage of GDP is

expected to fall, but to still exceed the Government's surplus target of one per cent of GDP during the major part of the forecast period (see Table 3).

The slowdown in growth in Sweden is expected to be moderate as the conditions for growth are assessed as good. Savings in both the household and public sectors are high. Property prices are stable and the direct effects of the financial turmoil are expected to be relatively slight in Sweden.

■ ■ Unemployment is expected to rise as economic growth slows down

Developments in the labour market at the beginning of the year were in line with the assessment made in the February Monetary Policy Report. The number of persons employed has continued to increase, but at a slower rate than last year. The numbers of newly-registered vacancies and redundancies also indicate a gradual slowdown in demand for labour in the coming period. The slowdown in the economy means that employment growth is now expected to be lower than was forecast earlier. The inflow of persons into the labour force has increased rapidly in recent years as the labour market situation has improved. When the demand for labour declines, the number of persons in the labour force usually also grows at a slower pace. However, demographic reasons would indicate that the labour force will continue to increase over the coming years, despite the expected lower employment. It is above all the expected lower employment growth that leads to the assumption that unemployment will rise and be higher than in the earlier forecast.

■ ■ Resource utilisation assessed as high now but will fall sooner

According to the different measures that the Riksbank usually uses, resource utilisation was higher during the fourth quarter of last year than the Bank assessed in February, both in terms of the number of hours worked and in terms of GDP. At the same time, the number of persons available on the labour market and the number of persons who are unemployed has been largely as expected at the beginning of the year. This indicates a slightly lower resource utilisation in the labour market than is indicated by the number of hours worked. An important contributory factor to the strong growth in the number of hours worked has for a long time been a constant decline in absence from work. The effects of a lower absence at workplaces can hardly be interpreted to mean that the economy's resources are now more strained than before, as this is largely a question of a decline in sick leave. Unemployment is expected to be higher than assumed in the earlier forecast throughout the entire forecast period. All in all, resource utilisation is expected to remain unchanged initially, but to then fall slightly more quickly than assumed in the earlier forecast.

■ ■ Continued high cost pressures

The higher unemployment is expected to put some downward pressure on the increase in hourly wages, and the forecast for these is thus revised down slightly. Productivity growth in the economy has at the same time been weaker last year than was forecast in the February Monetary Policy Report. As in the previous report, the downturn in productivity is assessed as temporary and growth is expected to gradually return to the trend level. Unit labour costs are expected to increase more quickly this year than in the earlier forecast. However, slightly lower growth in wages and lower employer's contributions will contribute to a slightly slower increase in unit labour costs next year. All in all, unit labour costs will increase slightly less than was previously forecast. Cost pressures are expected to remain high this year and then to slow down gradually.

■ ■ Energy and food prices contribute to high inflation

Inflation has risen rapidly since last summer and is expected to continue to rise over the coming months. As in other countries, the high inflation rate is primarily linked to higher energy and

food prices. Increased cost pressures and rising interest costs have also contributed to the upturn. Towards the end of the forecast period inflation is expected to return to the target level as cost pressures slacken and energy and food prices no longer rise at the same high rate.

Compared with the forecast in the Monetary Policy Report the inflation forecast remains largely unchanged in the short term. The effects this year of unexpectedly low outcomes as a result of revisions to weighting in the CPI are counteracted by the expectations of higher energy and food prices. Next year inflation is expected to be slightly higher as a result of higher energy prices. When adjusted for energy prices, inflation is revised down slightly compared with the Monetary Policy Report, which is due to the assumption now that cost pressures and resource utilisation will be slightly lower.

Rising interest costs for home-owners mean that CPI inflation will exceed 3 per cent on average during 2008. Given the Riksbank's interest rate path in this Update, the forecast is that CPI inflation will exceed CPIX inflation towards the end of the forecast period as a result of households' interest expenditure continuing to rise more quickly than prices of other goods and services. The latter is primarily a lingering effect of property prices rising substantially over a long period of time.

■ ■ Repo rate path unchanged since February

The Riksbank has the same view of how the repo rate will develop in the future as in February. As in the previous interest rate decision, the Riksbank has made an assessment of how the different counteracting factors can be expected to influence growth and inflation.

On the one hand, the economic downturn in the United States and the continuing financial market turmoil will subdue growth in the world economy. Such a development has consequences for the Swedish economy and for the inflation rate. GDP growth in Sweden is now expected to be lower towards the end of the year and at the beginning of next year. Resource utilisation is also expected to fall back slightly more quickly now than was forecast earlier. This could indicate a slightly lower path for the repo rate.

On the other hand, inflationary pressures in the world economy have been higher than expected as a result of sharp rises in oil, food and commodity prices. This has contributed to inflation being higher now than for a long time in many parts of the world, in particular Sweden. The already high inflation rate is expected to rise further in 2008 and the assessment is that inflation will fall back towards the target level at a slower rate than was assumed in the forecast published in the Monetary Policy Report. This could indicate a higher repo rate path than in the previous forecast.

These counteracting factors also mean that there is great uncertainty over economic developments and therefore also over the future path of the repo rate. The Riksbank has pointed out these risks in earlier reports and they still remain. The assessment today is that the repo rate will remain at 4.25 per cent in 2008. If the financial turmoil continues and economic activity in Sweden and abroad is weaker than expected, the interest rate may need to be lower. If cost pressures are higher than forecast, the Riksbank may need to raise the repo rate.

The future direction for monetary policy will depend, as usual, on how new information on economic developments abroad and in Sweden will affect the prospects for inflation and economic activity in Sweden.

Tables

Table 1. Inflation, annual average

Annual percentage change

	2007	2008	2009	2010
CPI	2.2	3.5 (3.4)	2.8 (2.5)	2.3 (2.3)
CPIX	1.2	2.6 (2.5)	2.4 (2.2)	2.0 (2.1)
CPIX excl. energy	1.5	2.0 (2.2)	2.2 (2.2)	2.1 (2.2)

Note. The assessment in the Monetary Policy Update is stated in parentheses. CPIX is CPI excluding household mortgages interest expenditure adjusted for direct effects of changed indirect taxes and subsidies.

Sources: Statistics Sweden and the Riksbank

Table 2. Inflation, 12-month rate

Annual percentage change

	Mar. -07	Mar. -08	Mar. -09	Mar. -10	Mar. -11
CPI	1.9	3.4 (3.4)	2.9 (2.6)	2.4 (2.4)	2.2 (2.2)
CPIX	1.2	2.3 (2.3)	2.5 (2.2)	2.1 (2.1)	1.9 (2.0)
CPIX excl. energy	1.2	2.0 (2.2)	2.1 (2.2)	2.2 (2.3)	2.1 (2.2)

Note. The assessment in the Monetary Policy Update is stated in parentheses. CPIX is CPI excluding household mortgages interest expenditure adjusted for direct effects of changed indirect taxes and subsidies.

Sources: Statistics Sweden and the Riksbank

Table 3. Key figures

Annual percentage change unless otherwise specified

	2007	2008	2009	2010
GDP, the world	4.9 (4.8)	3.8 (4.1)	4.0 (4.2)	4.5 (4.3)
Crude oil price, Brent USD/barrel, annual average	73	103 (89)	102 (87)	100 (86)
Exchange rate, TCW index, annual average	125.2	123.3 (124.1)	122.4 (123.1)	122.5 (122.9)
Repo rate, per cent, annual average	3.5	4.3 (4.3)	4.3 (4.3)	4.3 (4.3)
General government net lending, percentage of GDP	3.4 (3.1)	2.9 (2.3)	1.4 (1.7)	0.9 (1.6)
GDP	2.6 (2.5)	2.6 (2.4)	1.8 (2.0)	2.8 (2.8)
GDP, calendar adjusted	2.8 (2.8)	2.4 (2.1)	1.9 (2.2)	2.5 (2.5)
Numbers employed, aged 15-74	2.5 (2.5)	1.1 (1.1)	-0.1 (0.2)	0.0 (0.1)
Unemployment, aged 15-74 (EU definition)*	6.1 (6.1)	6.0 (5.9)	6.2 (5.9)	6.3 (5.8)
Hourly wage in economy as a whole	3.4 (3.6)	4.5 (4.2)	3.8 (4.0)	3.8 (3.8)

*Percentage of the labour force

Note. The assessment in the Monetary Policy Update is stated in parentheses.

Sources: IMF, Intercontinental Exchange, National Mediation Office, Statistics Sweden and the Riksbank

Table 4. International GDP

Annual percentage change

	2007	2008	2009	2010
USA	2.2 (2.2)	1.1 (1.7)	1.9 (2.5)	3.1 (3.0)
Euro area	2.6 (2.7)	1.4 (1.7)	1.3 (2.0)	2.0 (2.1)
OECD	2.7 (2.7)	1.6 (2.1)	2.0 (2.5)	2.7 (2.7)

Note. The assessment in the Monetary Policy Update is stated in parentheses.

Sources: Bureau of Economic Analysis, Eurostat, OECD and The Riksbank

Table 5. Repo rate forecast

Per cent, quarterly average

	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q1 2010	Q1 2011
Repo rate	4.1 (4.1)	4.3 (4.3)	4.3 (4.3)	4.3 (4.3)	4.3 (4.3)	4.3 (4.3)	4.3 (4.3)

Note. The assessment in the February Monetary Policy Report is stated in parentheses.

Source: The Riksbank

Tabell 6. Latest outcome and previous forecasts for central forecast variables

Annual percentage change unless otherwise specified

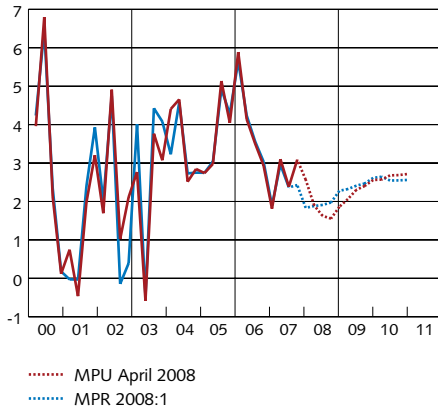
Key figures	Period	Outcome	MPR 2008:1
GDP, calendar adjusted	Q4	2.8	2.4
Hours worked, calendar adjusted	Q4	3.6	2.7
Numbers employed, aged 15-74 ¹	Q1	1.7	1.7
Unemployment, aged 15-74 (EU definition) ^{1, 2}	Q1	5.9	5.9
Exchange rate, TCW index, level	Q1	124.6	125.0
CPI	March	3.4	3.4
CPIX	March	2.3	2.3
CPIX excluding energy	March	2.0	2.2

¹ Outcome for Quarter 1 refers to the mean value for January and February.² Percentage of the labour force, seasonally adjusted

Sources: Statistics Sweden and the Riksbank

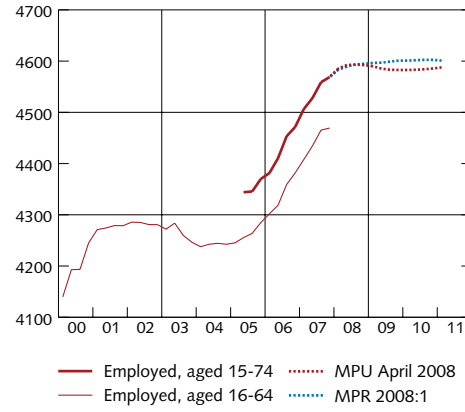
Figures

Figure 5. GDP
Quarterly changes in per cent calculated as an annual rate, seasonally-adjusted data



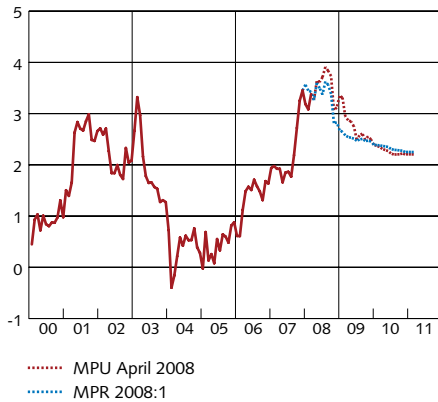
Sources: Statistics Sweden and the Riksbank

Figure 6. Number of employed
Thousands of persons, seasonally adjusted data



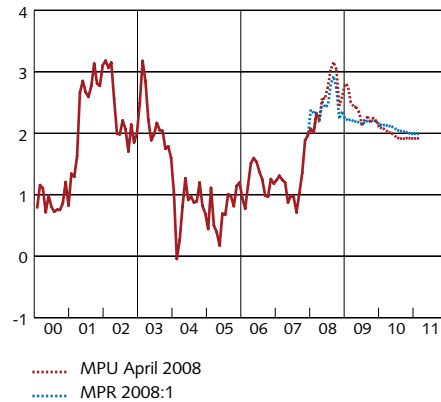
Sources: Statistics Sweden and the Riksbank

Figure 7. CPI
Annual percentage change



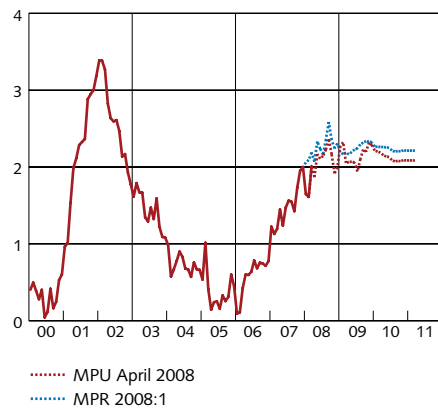
Sources: Statistics Sweden and the Riksbank

Figure 8. CPIX
Annual percentage change



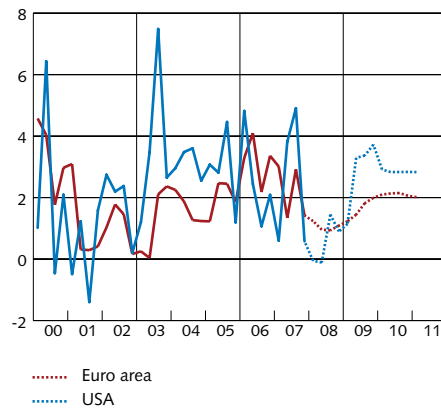
Sources: Statistics Sweden and the Riksbank

Figure 9. CPIX excluding energy
Annual percentage change



Sources: Statistics Sweden and the Riksbank

Figure 10. GDP in the USA and the Euro area
Quarterly changes in per cent calculated as an annual rate, seasonally-adjusted data



Sources: Bureau of Economic Analysis, Eurostat and the Riksbank

Note. MPU refers to the Monetary Policy Update and MPR refers to the Monetary Policy Report. Broken lines represent the Riksbank's forecast.