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■ Monetary policy and the situation in the Swedish economy

Deputy Governor Svante Öberg spoke at a seminar arranged by TCO (The Swedish Confederation for Professional Employees) on Thursday. In his speech Mr Öberg presented his view of the economic situation. He saw risks that GDP growth in the United States would be weaker than the Riksbank assumes in the Monetary Policy Update. Growth in Sweden would also slacken, but not as much. At the same time, there is a risk that inflation may be higher both abroad and in Sweden.

"Developments in the US economy have continued to deteriorate in recent months. This is largely linked to the problems in the financial markets. GDP growth has largely stagnated, employment has begun to fall and unemployment has begun to rise. US companies' and households' expectations of the future are very pessimistic. It is difficult to believe that a recovery can get started until there is a better picture of where the losses in the financial system are and until the fall in house prices has come to a halt. There is a risk that the slowdown in the United States will be more prolonged than we are assuming in the Monetary Policy Update," began Mr Öberg.

"Europe has fared better than the United States so far. This is because, for instance, the origin of the financial crisis is in the United States and the financial market turmoil has not been as great in Europe. But given the slowdown in the United States and the financial market turmoil it is reasonable to assume there will also be a slowdown in Europe," said Mr Öberg.

"In emerging and developing countries, on the other hand, GDP growth is still high. The strong world growth in recent years has brought rising commodity prices. This has led to rising inflation both in emerging economies and in more developed countries. The most probable outcome is that inflation will decline next year. Normally inflation wanes when growth slows down, although after a time lag. But there is a risk that the inflation process will be more prolonged. All in all, I therefore saw downside risks with regard to world GDP growth, but upside risks with regard to inflation at the most recent monetary policy meeting," continued Mr Öberg.

"Growth in Sweden will also slow down. In the Monetary Policy Update we are expecting a GDP growth rate of just over 2.5 per cent this year and just under 2 per cent next year. Exports are negatively affected by the weaker international developments. Household consumption will be subdued by weaker growth in real disposable incomes, poorer growth in real wealth and subdued expectations of the future," said Mr Öberg.

At the same time, there are several factors indicating that the slowdown will not be so severe. The cold figures for the Swedish economy are not yet showing any significant signs of a slowdown. In addition, it should be noted that the current account balance and general government finances are strong, which provides us with a good starting point for managing a slight slowdown. Moreover, the financial sector in Sweden has fared relatively well in the international financial turbulence, which reduces the risk of a serious credit crunch," said Mr Öberg. The most recent Economic Tendency Survey for April shows that the situation in the Swedish economy remains largely unchanged from the previous month and that the economy is stronger than normal," continued Mr Öberg.

"The slowdown in growth means that employment will probably be weaker than in recent years. I agree on the whole with the picture of economic developments in Sweden painted in the Monetary Policy Update, but on this point my own assessment is slightly different. I believe there will be a slightly more prolonged process with a continued increase in employment this year and a continued tendency towards an increase in the number of hours worked per person employed. The March figures from the labour market surveys (AKU) were also slightly stronger than predicted in the Update," continued Mr Öberg.

"Wage increases have so far been moderate after the most recent wage bargaining rounds last year. The rate of wage increase was 3.9 per cent in January and February, according to preliminary statistics from the National Mediation Office. But the wage increases may have been underestimated as a result of not all wage increases being included in the preliminary statistics, the number of employed having increased rapidly and the selection of companies in the wage statistics having been partly changed. It is important to clarify the significance of the latter factor and to produce data on the precision of the estimates of wage growth," said Mr Öberg.

"Prior to the wage bargaining rounds in 2007 I was fairly optimistic in the sense that they would largely be implemented in good time before the old agreements expired, that they would be implemented without any major conflicts and that they would result in wage increases that were compatible with the Riksbank's inflation target. But when the agreements began to be complete my optimism waned. The levels of the centrally-agreed wage increases were much higher than in the previous wage bargaining rounds. The possibilities to conduct a relatively expansionary monetary policy with low interest rates and to nevertheless meet the inflation target declined. I therefore advocated a more rapid increase in the Riksbank's policy rate last year," said Mr Öberg.

"What has happened since last spring is that economic developments have been poorer than we were expecting then. The financial market turmoil has led to a severe slackening of economic activity in the United States, which has a dampening effect on economic developments in other countries and also in

Sweden. This may in turn have made companies more cost conscious and less likely to recruit new staff and to raise wages more than the central agreements. Nevertheless, my assessment is that wages could very well increase more than is predicted in the Monetary Policy Update. Capacity utilisation is high and unemployment is low," observed Mr Öberg.

"Inflation has risen and is now substantially above the Riksbank's target. CPI inflation was 3.4 per cent in March 2008. Inflation expectations are above the inflation target, both at two and five years ahead. One explanation for the high inflation is our own interest rate raises. Another explanation is the increases in commodity prices. A third explanation is cost movements in Sweden. Wages are expected to increase more quickly than in recent years and productivity is expected to increase more slowly. This means that unit labour costs will increase much faster than before," said Mr Öberg.

"The Executive Board of the Riksbank decided at the April monetary policy meeting that the repo rate should remain at 4.25 per cent and our assessment was that the most probable outcome was that it would remain at this level for the rest of the year. I supported both the interest rate decision and the repo rate forecast. But in my opinion there was a slightly greater probability of an increase in the policy rate during the year than of a cut in the rate. The risk is that the inflation process will be more prolonged, both abroad and in Sweden," concluded Mr Öberg.