INFLATION ASSESSMENTS AND MONETARY POLICY

Monetary policy is constructed in the light of an assessment of inflation in the coming twelve to twenty-four months. In each report the time perspective is shifted approximately one quarter into the future. This means that even if the Riksbank's appraisal of future economic activity and inflation is unchanged, different monetary policy conclusions may be called for because the period being assessed has shifted ahead. For the time being, monetary policy will be based primarily on an assessment of consumer price tendencies from the third quarter of 1998 up to mid 2000.

Monetary policy is sometimes described with a simple rule of thumb: if the inflation forecast in the main scenario (based on an unchanged instrumental rate) indicates that inflation will deviate from the target in twelve to twenty-four months time, then the instrumental rate will have to be adjusted accordingly. However, predicting future inflation is not straightforward. The Riksbank therefore also assesses the uncertainties in inflation's future path.

The overall picture of inflation prospects consists in practice of an assessment of probabilities. Together with a main scenario—the most probable outcome—a number of risk scenarios are weighted into the final assessment on which the construction of monetary policy is based. The uncertainty surrounding the main scenario is not necessarily symmetric. Upside risks predominate at times, while on other occasions it can seem more probable that inflation may be lower than in the main scenario.

The assessment in the main scenarios is supplemented by the appraisal of the risk spectrum, which can constitute an important argument for tightening or easing the monetary stance. Another matter than may be worth mentioning here is that the construction of monetary policy can be influenced by the inflation assessment's uncertainty as such. A high degree of uncertainty can be a reason for a more cautious construction in the sense that there may be grounds for deferring a repo rate adjustment until more is known about the situation, thereby avoiding excessively large shifts in interest setting and the formation of expectations. It should also be underscored than in its construction of monetary policy the Riksbank also considers various indicators of underlying inflation and the information they provide about the path of inflation and transitory effects.

MONETARY POLICY'S CONSTRUCTION

As there is a time lag before the Riksbank's monetary policy measures affect prices, policy has to be forward-looking. For this reason and in view of an expected increase in inflationary pressure, the Riksbank intended to make the monetary stance less expansionary by raising the repo rate 0.25 percentage points in December 1997. In the March report it was noted that inflation prospects seemed to have become more subdued. It was considered that effects of the Asian crisis would be somewhat more extensive and prolonged. Moreover, wage agreements concluded during the winter pointed to a comparatively restrained wage rise. Under these circumstances the repo rate was left unchanged.

Since then, inflation in Sweden has been weaker than the Riksbank and many other observers had foreseen. Inflation in the rest of the world has also been unexpectedly low. Transitory effects lie behind the tendency in Sweden but the underlying rate of inflation has also fallen. Meanwhile, the real economy seems to be developing much as expected.

Inflation in the main scenario is now below the target in the perspective of twelve to twenty-four months that is most relevant for monetary policy. The reported assessment of uncertainties supports this. Against this background it is concluded that, at least for a time, the monetary conditions can be moved in a somewhat more stimulatory direction without risking fulfilment of the inflation target.