To sum up, price pressure from producers and raw materials is still weak, except in the case of non-durable consumer goods. But the weak exchange rate this autumn and futures prices for raw materials do point to some upward price tendency in the future.

Interest rates, exchange rate and money supply

TURBULENT FINANCIAL MARKETS

Long-term nominal interest rates have been falling continuously for a number of years, in Sweden as well as abroad. The downward international trend has contributed to the lower bond rates in Sweden. Other factors have presumably been growing confidence in the low-inflation policy and the consolidation of government finances.

The global financial unrest is probably one reason why many market players revised risk assessments during the summer. Equity positions were closed—to reduce future risks or cover losses that had already been incurred—in favour of, above all, interest-bearing securities with a lower risk. Bond rates fell in the United States and Europe, including Sweden. Investors switched by degrees to major and historically safe currencies such as the German mark and the US dollar, which accordingly strengthened at the same time as German and US bond rates went on falling. The downward international interest rate trend meant that Swedish long bond rates also fell but not to the same extent. The long-term interest rate differential with Germany therefore rose in the early autumn (Annex: Fig. 11).

MONETARY POLICY’S ECONOMIC IMPACT

The Riksbank’s main monetary policy instrument is the repo rate. Simplifying somewhat, the Riksbank influences other interest rates in Sweden by altering the repo rate, which is the short-term rate for the private banks’ deposits in and borrowing from the Riksbank. Via these market interest rates an influence is exerted in turn on economic activity, for example business investment and household consumption, and thereby ultimately on price formation. However, the Riksbank’s actions do not have the same effect on every type of interest rate. The rates with the shortest maturities are controlled by the repo rate more or less directly, while those with longer maturities are also strongly influenced by factors which the Riksbank does not control directly, for example the construction of fiscal policy, the development of international interest rates and the credibility of overall economic policy’s commitment to price stability. It should also be noted here that households and most firms finance their procurements and consumption mainly at interest rates which differ from the quoted market rates. The loans are usually provided by banks and house mortgage institutions at rates that to some extent also mirror credit risks and institutional competition.

Monetary policy also influences the course of inflation via the exchange rate because exchange rate movements have effects on, for example, demand and investment in the internationally oriented sector of the economy. Under normal conditions a repo rate increase, or expectations of this, leads to a stronger exchange rate because the higher interest rates make Swedish assets more attractive than equivalent investments in other currencies; this attracts foreign capital to Sweden, with an increased demand for Swedish kronor. A change in the exchange rate normally affects inflation via changes in import prices. All else equal, a relatively permanent weakening or strengthening of the exchange rate will affect demand via shifts in relative prices between Swedish and imported goods. This in turn affects inflation.