

direction and amounted to 0.6 percentage points, of which the major part came from the cut in tobacco tax in August. In addition to these shocks, which are perceived as having only transitory effects on inflation, the trend rate of inflation (calculated excluding transitory effect) has been weak in the past year. Underlying

inflation in October was 0.7 per cent in terms of UND1X and 1.7 per cent according to UNDINH. These comparatively low levels reflect a combination of subdued domestic inflationary pressure and weak international price tendencies.

## INFLATION ASSESSMENTS AND MONETARY POLICY

Monetary policy is constructed in the light of an assessment of price developments 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 2000 Q1 up to and including 2000 Q4.

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 twenty-four months time, then the instrumental rate should 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 formation 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 will be lower than in the main scenario. The assessment in the main scenario is supplemented by the appraisal of the risk spectrum, which can constitute an important argument for tightening or loosening the monetary stance. Another matter than may be worth mentioning here is that the formation 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 attitude, thereby avoiding excessively large shifts in interest setting and the formation of expectations. Furthermore, it should be underscored that in its formation 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.