The overall growth prospects have deteriorated since the December Report. GDP is now judged to fall in 1999 and a stabilisation is not foreseen until 2000.

WEAK PRICE TREND

Inflationary pressure in the OECD area has gone on easing, mainly in producer prices, for which the increases are the lowest since the early 1980s. This is particularly evident in the euro area. In the coming two years, the inflationary pressure is expected to be low in connection with weaker international demand, increased competition and overcapacity in many sectors. In 1999 the rate of inflation is judged to be just under 1.5 per cent and then rise to somewhat above 1.5 per cent in 2000. An increase in commodity prices is foreseen from the present low levels. A downward tendency is expected, on the other hand, for prices for manufactured exports in national currencies in 1999, when they are expected to fall by around 1 per cent, followed by an increase of 1.5 per cent in 2000.

17 Between them these three countries receive almost a quarter of Swedish exports.

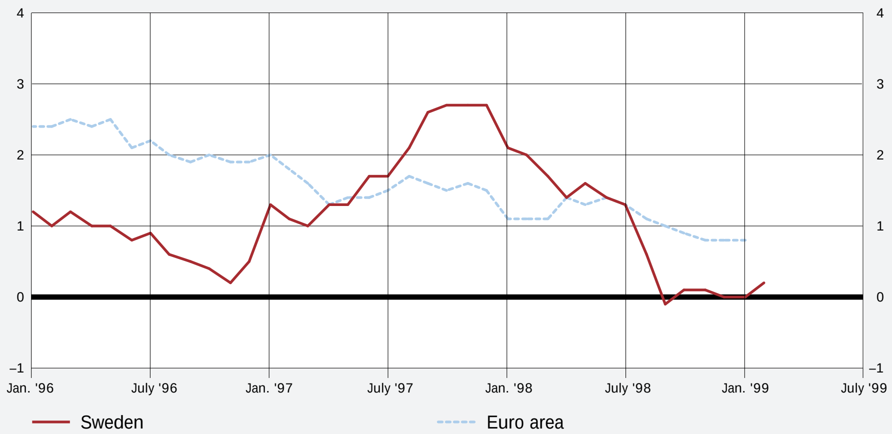
18 The Bank of Japan's targeted instrumental rate has been 0.15 per cent since 12 February 1999.

OVERVIEW OF ECB'S MONETARY POLICY STRATEGY

On 1 January 1999 the European Central Bank (ECB) assumed the responsibility for monetary policy in the euro area. The primary policy objective is the maintenance of price stability in the euro area. The main elements of the monetary policy strategy are a quantitative definition of price stability, a quantitative reference value for the growth of a broad monetary aggregate (M3) and a broadly based assessment of the outlook for future price developments and the risks to price stability in the euro area as a whole.

The quantitative definition of the price stability objective that the ECB Governing Council has adopted is: "*price stability shall be defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2 per cent*'" This presumably means that an annual rate of increase between 0 and 2 per cent com-

Figure B1.
HICP for the euro area and Sweden.
Percentage 12-month change



Sources: Eurostat and Statistics Sweden.

plies with the ECB's price stability definition. Monetary policy's focus is on the euro area as a whole, not on developments in particular countries. The objective is to be fulfilled over the medium term, which acknowledges that short-run shocks which monetary policy neither can nor ought to counter may lead to inflation moving outside the interval. By focusing on the medium-term horizon, the ECB's monetary policy, like the Riksbank's, is to contribute to making such shocks transitory.

The reference value for M3 growth, which has been set at 4.5 per cent for 1999, is based on medium-term assumptions of an annual real GDP growth trend of 2-2.5 per cent and an annual decline in M3's velocity of circulation of 0.5-1 per cent. Derived from the quantity equation,[19] this gives an implied inflation target between 1 and 2 per cent. Note that a reference value is not the same as a target interval. The ECB is not committed by its reference value to correct deviations of monetary growth in the short term. In other words, deviations in M3 growth from the reference value will not automatically result in interest rate adjustments.

The analysis of monetary growth is accompanied by an overall assessment of the prospects for price stability. This assessment is based on a wide range of economic and financial indicators, including wages, exchange rates, interest rates, various measures of real activity, fiscal policy indicators and surveys of business and consumers. In the light of these variables, inflation forecasts are produced, though not published.

19 The quantity equation expresses the relationship between the change in the money supply *(M)* and the velocity of circulation *(V)* on the one hand and the change in real GDP *(Y)* and the price level *(P)* on the other: $dM + dV = dY + dP$. The data then give an implied inflation target between 4.5 –1 –2.5 = 1 and 4.5 – 0.5 – 2 = 2 per cent.

Interest rates and exchange rate

The development of interest rates and the exchange rate is of considerable importance for future inflationary pressure. To some extent, the Riksbank's assessment of future movements in these rates is conditioned in turn by the circumstance that the inflation forecast for the coming twenty-four months is based on the technical assumption of an unchanged repo rate. For market interest rates, the impact of the repo rate is crucially dependent on maturities—the shorter the maturity, the stronger the effect. The three-month rate is therefore presumed to be virtually stationary during the forecast period. Swedish long bond rates are assumed to rise around half of a percentage point up to the end of the forecast period. International long bond rates are likewise assumed to rise somewhat from today's historically low levels. The long-term interest rate differential with Germany is expected to become more or less stable around the current level.[20]

In the December Report it was judged that in the coming two years the krona would appreciate. The krona was assumed to remain weak at first and then strengthen in the latter part of 1999 when the turbulence had subsided; the appreciation was then expected to slow down towards the end of the forecast period.

A gradual appreciation of the krona is foreseen in the forecast period.

The exchange rate assessment is broadly unchanged. In the longer run the krona is expected to appreciate in accordance with earlier assessments of the real exchange rate's path as the economy approaches both external and internal equilibrium.[21] In an international comparison, Sweden's net external debt relative to GDP is relatively high. Continued current-account surpluses are therefore likely to be needed in the coming years, which points to a gradual adjustment of the exchange rate towards a sustainable equilibrium.

The nominal TCW exchange rate is judged to