Monetary Policy Update September 2011

SVERIGES RIKSBANK

During the summer, concern over public finances in the United States and the euro area has increased, and the prospects for global growth have deteriorated. The fiscal policy tightening expected in several countries will be more far-reaching than was previously assumed. Although more expansionary monetary policy will contribute to counteracting the effects on growth, it will not fully counteract them. Growth abroad will be weaker, and will affect Sweden through fewer exports and lower confidence. This means that the slowdown in the Swedish economy will be slightly more pronounced than was forecast in July.

The political uncertainty abroad makes it particularly difficult to forecast future developments. The basic assumption for the forecast is that credible fiscal policy measures will be decided on in the coming period, and that market agents and households will regain confidence in Sweden and abroad. This, together with a more expansionary monetary policy, will mean that growth in Sweden rises during the course of next year.

Developments on the Swedish labour market are now slowing down and the improvement over the coming year will be slow. All in all, resource utilisation in the Swedish economy is now expected to be slightly lower than normal. There is little inflationary pressure in the Swedish economy. CPIF inflation amounted to 1.6 per cent in July, but is expected to gradually rise towards 2 per cent within a couple of years. The currently high CPI inflation is expected to fall towards 2.5 per cent in the same period. In the long run, when the repo rate has stabilised, the two measures of inflation will coincide.

Given the assumption that the slowdown in the Swedish economy is expected to be more pronounced, the Riksbank assesses it is appropriate to hold the repo rate unchanged now at 2 per cent and to postpone continued increases somewhat. A lower repo-rate path will gradually stabilise inflation around the target of 2 per cent and resource utilisation around a normal level.

Figure 1. Repo rate with uncertainty bands
Per cent, quarterly averages

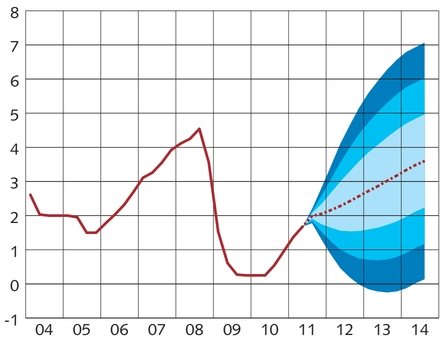


Figure 2. GDP with uncertainty bands
Annual percentage change, seasonally-adjusted data

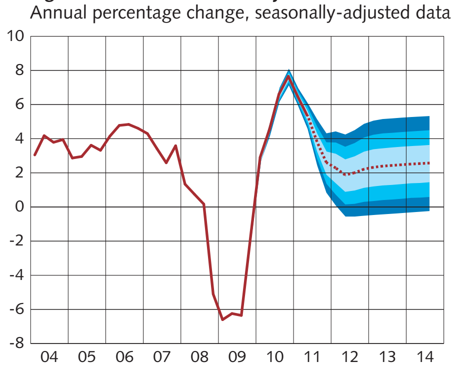


Figure 3. CPI with uncertainty bands
Annual percentage change

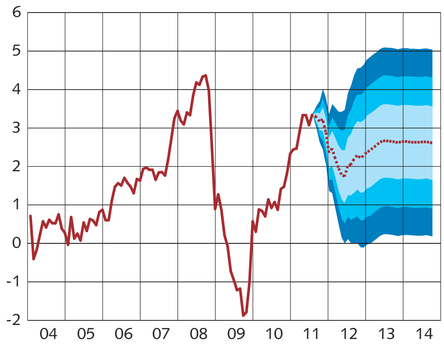
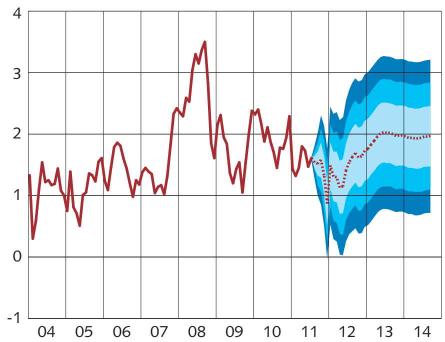


Figure 4. CPIF with uncertainty bands
Annual percentage change



Outcome Forecast 90% 75% 50%

Note. The uncertainty bands in the figures are based on historical forecast errors, see the article "Calculation method for uncertainty bands" in MPR 2007:1.

Sources: Statistics Sweden and the Riksbank

The economic outlook and inflation prospects

The economic and inflation prospects reported in this Monetary Policy Update are based on the assessments made in the Monetary Policy Report in July and the forecast updates made since then. The forecasts are based on the assumption that the repo rate is held unchanged at 2 per cent, and that future increases in the repo rate are postponed slightly, compared to the assessment in July.

The uncertainty in the financial markets

During the summer the financial markets have been characterised by considerable unease, which stems from the sovereign debt problems in the euro area and the United States. Poorer outcomes for macro statistics have also contributed to the turbulence. The Stockholm Stock Exchange has fallen substantially, in line with stock markets abroad, and volatility has been high. While the demand for equity and other high-risk assets is falling, there is an increase in demand for safer assets, such as government bonds. This has meant, for instance, that Swedish, German and US government bond yields have fallen to historically low levels. Despite the volatile market developments over the summer, interest rates on the Swedish interbank market have not risen appreciably. Swedish banks are well-capitalised and have good access to funding in foreign currency.

Poorer developments abroad

The increased concern over developments in public finances dampens global growth prospects. There is also reason now to believe that fiscal policy in both the United States and the euro area will need to be tightened even more than was previously assumed. These measures are necessary to dampen concern and increase confidence on the financial markets, but they will have a restricting effect on growth over the coming years. However, it is difficult to assess developments at present, as they depend on the willingness and ability of the political systems in the United States and Europe to implement measures that are credible and sustainable.

The emerging economies in Asia, which have earlier shown tendencies towards overheating, are now feeling the effects of an economic slowdown. In China, manufacturing output is weaker than expected, while the purchasing managers' index points to expectations of slower economic growth. Inflation is high, however, and in July the Chinese central bank raised its policy rate. In India, too, inflation problems have led to tighter monetary policy. In Japan the recovery from the fall in production following on from the tsunami is continuing, but an increasingly strong yen may dampen the recovery in the period ahead. However, good growth in the world economy as a whole is still expected, although prospects have deteriorated slightly.

US economy weaker than expected

GDP growth in the United States was weak during the first half of 2011. The growth in corporate investment and increase in employment were low. In addition, household consumption was weak, which is linked to households trying to reduce their debts and restore their net wealth. The housing market in the United States has also remained weak. Increased unease and uncertainty in the wake of Congress's budget discussions, Standard & Poor's downgraded credit rating for US government securities and the stock market fall will probably worsen the situation and all-in-all, domestic demand will continue to be weak.

Weaker prospects for domestic demand and the need for tighter fiscal policy mean that the forecast for growth in the United States has been adjusted down from the July assessment for most of the forecast period. As the necessary work on consolidating public finances starts, unease on the financial markets is expected to decline and confidence should return. Towards the end of the forecast period, when the effects of the large-scale fiscal policy tightening decline, and households' finances improve, the US economy will grow at a faster rate again.

Over the summer, inflation in the United States has developed as expected. The high energy prices have had a substantial impact and CPI inflation rose to 3.6 per cent in July. Underlying inflation has also risen, albeit from a significantly lower level. Productivity growth has slowed down and unit labour costs are increasing. However, as the spare capacity in the economy is expected to be great in the years ahead, inflation is forecast to fall as the effects of the increased energy prices decline.

■■ Slow recovery in the euro area

The Riksbank assessed earlier that the recovery in the euro area would progress slowly, but the new information received over the summer points to the recovery taking even longer. The increased uncertainty regarding public finances and global growth prospects has contributed to heavy stock market falls and increased borrowing costs for companies with lower credit ratings. The greater unease is to some extent based on uncertainty over whether the European Financial Stability Facility's resources can stretch to providing support to both Spain and Italy if this should prove necessary. Further fiscal policy measures in several countries are needed to ensure a sustainable development in public finances. The basis for the forecast is that credible decisions will be taken, which should dampen the turbulence in the financial markets.

Fiscal policy in the euro area is now expected to be even tighter than was forecast in July. The tighter policy is expected to further dampen willingness to consume and invest, and this contributes to a downward adjustment in the forecast for growth in the euro area in the coming years. As the debt consolidation problems decline and households and market agents feel confident again, growth in the euro area will increase again.

A lower oil price and low resource utilisation mean that inflation in the euro area is expected to continue to fall over the coming year, and to remain relatively low in the coming period. Weaker economic developments in the core countries of the euro area also contributes to this.

■■ Public finances problems in the spotlight

The Riksbank has long discussed the debt problems in the United States and the euro area. The July Monetary Policy Report showed an alternative scenario that illustrated a deeper crisis in Europe. In this scenario, growth fell heavily in Sweden's most important trading partners and interest rate spreads on the financial markets in Sweden rose substantially. There are similarities, but also major differences, between this scenario and the developments we are seeing now.

The effects on growth and inflation abroad are assessed to be much less than in the alternative scenario. Unlike the alternative scenario, the spreads for interest rates paid by households and companies in Sweden have not risen appreciably and the financial market in Sweden has so far functioned smoothly. All in all, this means that the effects of recent developments are expected to be much less than was outlined in the Monetary Policy Report's alternative scenario. But there is, of course, considerable uncertainty.

■■ Krona initially somewhat weaker

The financial unease that has characterised economic developments over the summer has led to a weakening of the krona. However, this weakening is not on a par with what happened in 2008 and 2009. The recent weakening is assessed as temporary. As fiscal policy tightening and debt consolidation are put in place in the euro area and the United States the financial turbulence will subside and the krona is expected to return to its earlier level as soon as next year.

■■ Swedish growth slowing down

The Riksbank's assessment in the Monetary Policy Report in July was that growth in the Swedish economy would slow down over the year, following a period of very strong growth. Now growth prospects abroad have deteriorated, and this together with the increased concern negatively affects the Swedish economy. GDP was still growing at a rapid rate in the second quarter of this year, but towards the end of the year the growth rate is expected to have slowed down to levels slightly below the historical average. Growth is now expected to be slightly slower over the coming year than was expected in the July Monetary Policy Report.

Confidence among market agents and households, both in Sweden and abroad, is expected to increase as decisions regarding fiscal policy tightening are made and credible programmes for debt consolidation are drawn up in the euro area and the United States. This, together with a more expansionary monetary policy, will mean that the growth rate in Sweden rises during the latter part of next year.

The Swedish economy is expected to grow faster than the economies in the euro area. Important reasons for this include the relatively good public finances in Sweden, which mean that fiscal policy tightening is unnecessary, and the fact that Sweden has not been affected by a declining housing market to the same extent as some countries in the euro area, and in particular the United States. GDP in Sweden is expected to grow by 1.7 per cent in 2012 and by 2.4 per cent in 2013.

■■ Public finance surplus

General government net lending is expected to be positive this year and amount to 0.5 per cent of GDP. In the coming years, it should strengthen further and is expected to be 1 per cent of GDP in 2013. It was assumed in the July Monetary Policy Report that the Swedish Government would propose adjustments in expenditure and income tax equivalent to around SEK 30 billion in 2012 and a further SEK 20 billion in 2013. However, as a result of the deterioration in the economic situation, the Government has now signalled that some measures, such as the fifth tax deduction for those in work, will be postponed. The Riksbank is therefore now assuming that the scope of the adjustments in expenditure and income tax will be around SEK 15 billion lower in 2012 than was previously forecast, while those in 2013 will be slightly higher.

■■ Households more cautious

The stock market fall during the summer has led to a decline in households' financial wealth. In addition, the rate of increase in house prices has slowed down. A decline in household wealth often means that households increase their saving to compensate. Moreover, the financial unease ought to have contributed to an increase in uncertainty regarding future income developments. The planned tax cuts will not be implemented and consumer confidence has fallen, which also contributes to an increase in saving. Additionally, the greater uncertainty means that households are not expected to take on as much debt as before. Some slowdown in indebtedness has already occurred, which is reflected in the fact that lending to households has been increasing more slowly for some time. This is probably due to the new regulations introduced regarding a mortgage ceiling and to the higher interest rates.

The upturn in household consumption during the first half of the year was primarily driven by increased purchases of durable goods and motor vehicles. As these groups of goods are probably more sensitive to changes in wealth, consumption of these goods is expected to increase relatively slowly during the autumn. Households' savings are at a high initial level, which means there is scope for households to reduce their saving and increase consumption as soon as the uncertainty declines. All in all, consumption is expected to be slower during the autumn and then to grow more quickly.

■■ Turbulence abroad affects Swedish exports

Swedish exports have grown rapidly since the financial crisis in 2008–2009, but the assessment in the July Monetary Policy Report was that exports would now enter a slower phase. Weaker developments abroad, combined with the financial unease, mean that exports are now expected to be even slower than previously forecast. Swedish exports consist to a large part of investment goods and in times of unrest companies tend to postpone their investments. This will thus have a negative effect on Swedish exports in the short term. Swedish exports are expected to grow in line with the Swedish export market during the forecast period. Imports are also expected to show slower growth, in line with exports and domestic demand.

■■ Investments continuing to increase

Investment is expected to continue to increase relatively strongly over the coming years. Capacity utilisation in manufacturing has risen and is now in line with the historical average. At the same time, production is expected to continue to increase. This will increase the need for capacity-enhancing investments in the business sector, where the investment level is currently relatively low. However, the slightly lower demand from abroad, and the increased concern over poorer economic prospects mean that the rate of increase in business sector investment is expected to be slightly lower in 2011 and 2012, compared with the forecast in July.

Housing investment, on the other hand, is expected to continue to increase rapidly. The demand for housing is high in relation to the supply. In addition, possibilities for tax deductions when renovating and a more expansionary monetary policy are expected to have a beneficial effect on housing investment. Public investments, which grew strongly in 2008 and 2009, will continue to increase in the period ahead, albeit at a somewhat slower pace.

All in all, total investment is expected to increase at a somewhat slower rate over the coming period, compared with the assessment made in July. Towards the end of the forecast period, investment as a percentage of GDP is expected to reach a normal level.

■■ Slow improvement in the labour market

The Swedish labour market has developed strongly since autumn 2009. Unemployment has fallen by around 1.3 percentage points since the end of 2009 and amounted to 7.4 per cent in July. The employment level is now higher than before the crisis, but seen as a percentage of the population it is still lower. Employment has risen, primarily in the services and construction sectors, while the recovery in the manufacturing industry has been slow. Indicators now point to a slightly weaker development in the labour market during the period ahead. Although the demand for labour is rising in most sectors, this is not as strong as before. The poorer economic prospects abroad will also gradually affect the Swedish labour market.

Compared with the assessment made in July, employment growth is now expected to be slower during the forecast period. As employment is still expected to increase more quickly than the number of persons in the labour force, unemployment will decline, but at a slower rate than was previously assumed. This slowdown will primarily take place over the coming year and after that the labour market will improve at a faster rate again. Towards the end of the forecast period unemployment is still expected to be slightly higher than was forecast in July.

■■ Resource utilisation close to a normal level

There is no unequivocal way of measuring resource utilisation, and the assessments are therefore always uncertain. The Riksbank uses several different indicators and statistical measures to assess resource utilisation. The indicators based on surveys point to resource utilisation in companies having risen rapidly and now being at normal levels. For instance, the National Institute of Economic Research's Economic Tendency Survey has for some time been indicating that there is a shortage of labour in many sectors and that capacity utilisation has risen rapidly in the manufacturing industry. However, the labour shortage has decreased somewhat recently. The level of unemployment indicates that there is still spare capacity in the economy. The overall assessment is that resource utilisation is now slightly lower than normal and that it will rise slightly more slowly during the forecast period than was assumed in the July Monetary Policy Report. However, resource utilisation is expected to be at a roughly normal level towards the end of the forecast period.

■■ Wages increasing moderately

During autumn this year and the whole of next year at least 525 central wage agreements, affecting more than 2.7 million employees, will be renegotiated. The parties in the manufacturing industry will be the first to renegotiate central wage agreements this autumn. The agreements in the manufacturing industry are coordinated for blue-collar and white-collar workers and are expected to serve as guidance for the rest of the labour market. The assessment is that wage formation will function smoothly, as it has done over the past 15 years, and will give rise to wage increases that are compatible with the inflation target. The negotiations take place in a situation where demand from abroad appears to be slowing down, which may in turn have repercussions for Swedish exports and thereby the Swedish manufacturing industry. According to the short-term wage statistics, wages are expected to increase on average by 3.3 per cent a year in 2012 and 2013, which is slightly lower than the forecast made in July. As growth increases and resource utilisation rises, wages are also expected to increase towards the end of the forecast period.

Productivity growth has been high for some time, and is now moving towards more normal levels. The outcome for the second quarter of this year was slightly higher than forecast in July. Now that production is slowing down more than expected as a result of lower demand from abroad, and uncertainty is increasing, growth in labour productivity will be low temporarily. This is because it takes time for companies to adjust their labour force to production. Towards the end of the forecast period productivity growth will amount to around 2 per cent a year.

Unit labour costs summarise the cost pressures from labour costs and productivity. These costs pressures will be low this year, as a result of both low increases in labour costs and relatively strong growth in productivity. Towards the end of the forecast period, when the rate of increase in both wages and productivity has normalised, the rate of increase in unit labour costs will also be in line with its historical average. The forecast for the rate of increase in unit labour costs has been adjusted downwards slightly for this year, but remains relatively unchanged for 2012 and 2013.

■■ Low underlying inflation but high CPI inflation

Underlying inflation is presently low, while CPI inflation is relatively high. In July the annual rate of increase in the CPI stood at 3.3 per cent. CPIF inflation, that is the CPI with a fixed mortgage rate, amounted to 1.6 per cent. When adjusted for energy prices, CPIF inflation amounted to a modest 1.1 per cent. The CPIF excluding energy is expected to remain around the current levels over the coming period, while both CPI and CPIF inflation are expected to fall as the rate of increase in energy prices slows down.

The fact that underlying inflation is currently low is linked to the weak development in food and goods prices. The strengthening of the krona earlier in the year is a contributory factor here. The low rate of increase in producer prices and unit labour costs will contribute to keeping inflation down in 2011 and early 2012. However, an expansionary monetary policy will contribute to rising resource utilisation and wage increases, which will gradually increase inflationary pressures in the economy. Inflation measured as the CPIF is expected to rise gradually over the coming years and to reach around 2 per cent in 2013.

The forecast for CPIF inflation in 2011 and 2012 has been adjusted down more than the forecast for the CPIF excluding energy. This is because both electricity and oil prices are now lower. Slightly lower cost pressures and resource utilisation will contribute to inflation being slightly lower in the longer term, too, compared with the forecast in July.

CPI inflation, which is currently high, will fall over the coming year to a lowest point of 1.7 per cent in 2012, and then gradually rise during the forecast period to just over 2.5 per cent in 2014. The forecast for CPI inflation is adjusted down, not just as a result of the lower underlying inflation and lower energy prices, but also because mortgage rates are not rising as quickly as was forecast in July.

The reason for CPI inflation being much higher than CPIF inflation is that mortgage rates will rise as a result of the Riksbank's repo-rate increases. Two years ago, the situation was the opposite, as the Riksbank's repo-rate cuts led to CPI inflation being much lower than CPIF inflation. During periods with large interest rate adjustments, measures of inflation that do not include interest rate costs, such as CPIF inflation, provide a better picture of underlying inflationary pressures. In the longer run, when the repo rate has stabilised, the two measures of inflation will coincide.

■■ Repo rate held unchanged

The repo rate is held unchanged at 2 per cent. The Riksbank assesses that it is now appropriate to wait a while before raising the repo rate and is postponing the continued increases in the repo rate. The repo rate will then be raised gradually and reach 3.6 per cent at the end of the forecast period.

Growth prospects abroad have deteriorated in connection with the unease that has arisen, and this will affect the Swedish economy, primarily during the autumn. Confidence among market agents and households, both in Sweden and abroad, is expected to increase as decisions regarding fiscal policy tightening are made and credible programmes for debt consolidation are drawn up in the euro area and the United States. This, together with a more expansionary monetary policy, will mean that growth in Sweden rises during the course of next year.

The improvement in the labour market is now proceeding more slowly, and the overall picture of resource utilisation is that it is still somewhat lower than normal. The difference between the different measures of inflation is still unusually large. CPI inflation is high, while CPIF inflation is low. When adjusted for rising energy prices, inflation is even lower, but as resource utilisation increases, underlying inflation is also expected to rise. An important condition for this forecast is that wage formation results in wage increases that are compatible with the inflation target. Over the past 15 years wage formation has functioned smoothly and the assessment in this Update is that this will also be the case this autumn and next year. Should these conditions change, so that the currently high CPI inflation has a more tangible impact on long-term inflation expectations and wage formation, future monetary policy may be affected.

Given the assumption that the slowdown in the Swedish economy is expected to be more pronounced, the Riksbank assesses it is appropriate to hold the repo rate unchanged at 2 per cent and to postpone continued increases somewhat. A lower repo-rate path will gradually stabilise inflation around the target of 2 per cent and resource utilisation around a normal level.

■■ Political uncertainty makes assessment difficult

Questions regarding political actions, with the accompanying financial unease, contribute to increasing uncertainty over future developments. One cannot rule out the possibility that the problems abroad could be greater than anticipated and thus have more tangibly negative effects on the Swedish economy. This could increase the need for expansionary monetary policy. On the other hand, the financial unease could also wane sooner than expected. Whether or not this is the case will largely depend on the political actions taken in Europe and the United States. In a more favourable scenario, confidence could improve rapidly and the slowdown could be less prolonged. This would reduce the need for more expansionary monetary policy.

New information since the July Monetary Policy Report

International economy

- The GDP outcomes published during the summer point to a weaker recovery abroad than was forecast in the July Monetary Policy Report. During the summer concern over public finances in the United States and the euro area has increased, which has had negative repercussions on the financial markets, at the same time as confidence indicators show declining confidence among households and companies around the world.

- In China, manufacturing output is weaker than expected, while the purchasing managers' index points to expectations of weaker economic growth. The CPI increased by 6.5 per cent, as an annual percentage change, in July and during the same month the Chinese central bank raised its policy rate for the third time this year. Monetary policy in India has also been tightened as a result of high inflation. In Japan, GDP fell by 0.3 per cent between the first and second quarters. Exports declined and imports increased during the second quarter, which may partly be effects of the earthquake and tsunami earlier this year. The fall in GDP was nevertheless lower than expected, partly because of an increase in public and private investment aimed at restoring lost production capacity.

- In the United States, the National Accounts figures have been revised, and historical GDP outcomes now show a larger decline in GDP during the crisis in 2008–2009 than had been indicated by earlier outcomes. During the second quarter of this year GDP increased by 1 per cent, calculated as an annual rate, which was weaker than expected. Household consumption increased marginally compared with the first quarter. Corporate investment showed a better development, providing the largest contribution to the growth rate during the second quarter. Confidence indicators such as consumer confidence and the purchasing managers' index have continued to fall. Weak employment growth contributes to unemployment remaining at 9.1 per cent. Productivity growth has slowed down and unit labour costs are increasing. CPI inflation rose from 3.5 per cent in June to 3.6 per cent in July, while underlying inflation rose from 1.6 per cent to 1.8 per cent.

- GDP in the euro area rose by 0.8 per cent calculated on an annual rate in the second quarter of this year. Germany, which has previously upheld the average GDP growth in the euro area, grew by scarcely half a percentage point, calculated as an annual rate, during the second quarter. Manufacturing output in the euro area fell by 0.7 per cent in June. Confidence indicators for the euro area, such as the purchasing managers' index for the manufacturing industry and the services sector, and the European Commission's Economic Sentiment Indicator (ESI) fell in July and August. In Germany the ZEW index, which measures assessments of economic prospects by institutional investors and analysts, continued to fall in July and August. Unemployment in the euro area was 10 per cent in July, which is unchanged compared with June, which was revised up from 9.9 per cent. The inflation rate in the euro area fell from 2.7 per cent in June to 2.5 per cent in July and remained unchanged in August, according to preliminary statistics.

- GDP in the United Kingdom rose by 0.7 per cent, calculated as an annual rate, between the first and second quarters of this year. However, GDP was slowed down by several temporary factors, such as fewer working days as a result of the royal wedding and a supply shock because of the tsunami in Japan. Weak growth in wealth has contributed to a recent decline in household optimism. Companies' optimism has also declined. The labour market has continued to be weak and unemployment has remained largely unchanged over the past two years. Inflation amounted to 4.4 per cent in July, which is far above the Bank of England's inflation target of 2 per cent.

Financial markets

- During the summer the financial markets have been characterised by considerable turbulence, which stems from the sovereign debt problems in the euro area and the United States. The poorer outcomes for macro statistics, particularly for the United States, have also lowered expectations of economic developments in the world as a whole, and thereby affected financial markets.

- The Stockholm Stock Exchange has fallen substantially, in line with other global stock markets, and volatility has been high. Since the Monetary Policy Report was published in July the Stockholm Stock Exchange (OMX) has fallen by around 17 per cent, the US stock market (S&P) by around 10 per cent and the euro area stock market (EuroStoxx) by around 19 per cent. Investors have demanded higher returns on higher-risk investments such as equity, which has resulted in falling share prices. At the same time, demand for safer assets, such as government bonds issued by countries with good public finances, has increased. This has meant that Swedish, German and US government bond yields have fallen to historically low levels. Demand for gold has also increased over the summer, which has pushed up the price of gold to new record highs.

- Government bond rates in southern Europe are still at very high levels. During the summer, interest rates rose substantially in Italy in particular, but also in Spain. A contributory factor to the financial markets putting greater focus on Italy is that during the summer it has been difficult to reach political agreement on the budget, at the same time as the country has a substantial funding need up to 2013. The ECB has made support purchases of several of the affected countries' government bonds to try to establish sustainable yield levels for these countries.

- Despite the volatile market developments over the summer, interest rates on the Swedish interbank market have not risen appreciably. Nor have developments so far contributed to any major increase in risk premiums on the interbank market, which was the case in autumn 2008, for instance.

- Since the most recent monetary policy meeting in early July, monetary policy expectations in Sweden – measured in terms of implied forward rates - have fallen across the entire forecast period. They show that there is now some expectation that the repo rate will be cut by a good 0.5 percentage points during 2012. According to Prospera's survey in July, monetary policy expectations are still higher than market pricing. In the longer run, monetary policy expectations are around 3.2 per cent according to the survey, which is lower than the repo rate path published in the July Monetary Policy Report.

- Monetary policy expectations measured in terms of implied forward rates have also fallen in the United Kingdom, the United States and the euro area. The US central bank left the interval for the policy rate unchanged at its most recent monetary policy meeting in August. They also communicated that the poorer economic prospects meant that the policy rate would probably remain at a very low level until at least the middle of 2013. The European Central Bank, which raised its policy rate to 1.5 per cent in July, chose to remain at this level at its most recent meeting in August. According to forward pricing, policy rates are expected to remain low over a long period of time in the euro area, the United States and the United Kingdom. The pricing points to policy rates in these countries not being raised until the turn of the year 2012/2013.

- The listed variable mortgage rates paid by households in Sweden have risen as a result of the repo-rate increase in July. Mortgage rates with longer maturities have fallen, on the other hand, but not as much as government and mortgage bond rates. The National Institute of Economic Research's survey on households' expectations of future variable mortgage rates shows that they are expecting mortgage rates to continue to rise. At the same time, the percentage of new loans at variable interest rates is declining in favour of loans with interest rates fixed for periods of up to five years. The rate of lending to households has declined slightly over the year. On the other hand, the rate of lending to companies is increasing, and has been positive since the start of the year, despite the rise in variable interest rates on bank loans to companies over the year.

- The Swedish krona has weakened slightly, in trade-weighted terms, since July. However, it has weakened less than it did during the financial crisis 2008–2009. The strong Swedish public finances and good growth in the Swedish economy have probably contributed to this.

GDP

- GDP in Sweden increased by 5.3 per cent during the second quarter compared with the same quarter last year (calendar-adjusted), and by 3.9 per cent compared with the previous quarter when calculated as an annual rate. This was a slightly stronger outcome than expected. However, developments in domestic demand and exports were weaker than forecast in the most recent Monetary Policy Report. Growth in imports was also slow, which meant that the contribution from net exports was unexpectedly large.

- The weaker developments abroad are expected to lead to slower growth in the Swedish economy over the coming quarters. Indicators such as the Economic Tendency Survey and the purchasing managers' index also point to this. The Economic Tendency Survey showed a decline in both July and August. It is now only slightly above the average level, which clearly shows that growth in the Swedish economy is slowing down. The recent turbulence in the financial markets has probably contributed to dampening sentiment among households and companies. GDP is now expected to be weaker during the second quarter of this year than was forecast in July.

- Household consumption grew by 2.3 per cent during the second quarter of this year, compared with the same quarter last year. Consumption of durable goods, cars and services contributed to the upswing. However, consumer confidence fell heavily in July and August. Above all, households became more pessimistic with regard to expectations of the Swedish economy. Households also became more pessimistic with regard to the outlook for their personal finances in the August survey. This also indicated that the percentage of households who consider it beneficial to save now has increased, and that the percentage of households taking on debt has decreased. On the other hand, households considered that the risk of becoming unemployed had declined. Weaker consumer confidence, falling asset prices and increased uncertainty indicate that consumption will slow down in the autumn. A weak retail trade index in July also points to this.

- Swedish exports have increased rapidly over the past year. However, monthly statistics on foreign trade point to a slowdown during the third quarter. During the economic slump in 2008 and 2009 it was primarily the input goods industry and investment goods industry that suffered. Data on export orders now show that these are the sectors showing a decline. Investment is also expected to increase at a slightly slower rate over the coming quarters, as the rate of increase in production slows down. The uncertainty over economic developments also contributes to dampening the rate of investment.

Labour market

- The positive developments in the Swedish labour market have continued since the forecast in July, but at a slightly slower rate. The number of employed and the number of persons in the labour force have been lower than expected and the employment rate and labour force participation have levelled off somewhat. Unemployment continued to fall to 7.4 per cent in July (seasonally-adjusted), which is in line with the assessment made in July.

- Indicators point to the labour market being unlikely to develop as strongly as before in the coming period. Although the Swedish Employment Service reports that the number of newly-registered job vacancies shows a rising trend, the increase is not as rapid as before. The number of redundancy notices has also risen slightly. According to the National Institute of Economic Research's Business Tendency Survey, employment plans also show that companies are not planning for as much new recruitment in the coming months as earlier in the year. The number of companies stating that they have a shortage of labour is not tending to increase at the same rate as before, either.

- The National Mediation Office's short-term wage statistics indicate that wages in the entire economy rose by an average of 2.1 per cent, calculated as an annual percentage change, during January to June this year. This is slightly less than expected, even taking into account the fact that the outcomes are revised up when further retroactive wage payments are included in the statistics. Wages are expected to increase by 2.7 per cent in 2011, which is a downward revision of almost 0.2 percentage points compared with the assessment in July.

- Statistics from the Confederation of Swedish Enterprise show that the premium rates in the collective pension insurance schemes in the business sector have been raised for blue-collar workers but lowered for white-collar workers. The net effect is negative. All in all, the changes mean that the contribution from payroll tax in the whole economy this year is now expected to be slightly lower than previously forecast. Unit labour costs are expected to increase faster than labour productivity this year, which entails rising unit labour costs this year. However, cost pressures in the Swedish economy in 2011 are expected to be lower than was previously assessed.

Inflation

- Having risen during the spring, inflation expectations have now fallen slightly. The National Institute of Economic Research's survey of household inflation expectations one year ahead indicates that these fell from 2.9 per cent in July to 2.5 per cent in August. Companies' inflation expectations also fell from 2.0 per cent in the first quarter to 1.8 per cent in the second quarter. The Prospera survey conducted in August shows that inflation expectations among money market agents fell marginally. In August, inflation expectations one year ahead were 2.5 per cent, expectations two years ahead were 2.3 per cent and five years ahead 2.2 per cent.

- CPI inflation is high now as a result of mortgage rates rising substantially as the repo rate has been increased. CPI inflation was 3.3 per cent in July.

- The annual rate of increase in the CPIF, that is, the CPI with a fixed mortgage rate, amounted to 1.6 per cent in July. Rising energy prices have kept CPIF inflation up. If energy prices are excluded from CPIF inflation, the rate of inflation is relatively low, around 1.1 per cent in July. The low outcome is largely explained by the slow rise in goods and food prices, which is partly connected to the strengthening of the krona over the past year.

Tables

The figures in brackets show the forecast in the previous Monetary Policy Report (July 2011).

Table 1. Repo-rate forecast
Per cent, quarterly average values

	Q2 2011	Q3 2011	Q4 2011	Q3 2012	Q3 2013	Q3 2014
Repo rate	1.7	2.0 (2.0)	2.1 (2.3)	2.4 (2.9)	3.0 (3.4)	3.6 (3.8)

Source: The Riksbank

Table 2. Inflation, annual average
Annual percentage change

	2010	2011	2012	2013
CPI	1.2 (1.2)	3.0 (3.1)	2.1 (2.7)	2.6 (2.8)
CPIF	2.0 (2.0)	1.5 (1.6)	1.5 (1.7)	2.0 (2.1)
CPIF excl. energy	1.5 (1.5)	1.0 (1.1)	1.6 (1.8)	2.0 (2.1)
HICP	1.9 (1.9)	1.4 (1.6)	1.4 (1.7)	1.9 (2.0)

Note. The rate of change in the CPI is based on revised index figures, which may differ from the established index figures. CPIF is CPI with fixed mortgage rates. HICP is an EU harmonised index of consumer prices.
Sources: Statistics Sweden and the Riksbank

Table 3. Summary of financial forecasts
Annual average, per cent, unless otherwise specified

	2010	2011	2012	2013
Repo rate	0.5 (0.5)	1.8 (1.8)	2.4 (2.8)	2.9 (3.4)
10-year rate	2.8 (2.8)	2.8 (3.2)	2.9 (3.8)	3.7 (4.3)
Exchange rate, TCW-index, 1992-11-18=100	129.3 (129.3)	121.8 (120.8)	120.4 (120.2)	119.4 (120.2)
General government net lending*	-0.2 (-0.2)	0.5 (0.9)	0.8 (1.2)	1.0 (1.4)

* Per cent of GDP
Sources: Statistics Sweden and the Riksbank

Table 4. International conditions
Annual percentage change, unless otherwise specified

GDP	2010	2011	2012	2013
Euro area (0.14)	1.7 (1.7)	1.7 (1.9)	1.1 (1.6)	2.0 (2.2)
USA (0.20)	3.0 (2.9)	1.6 (2.3)	2.0 (2.7)	2.8 (3.2)
Japan (0.06)	4.0 (4.0)	-0.8 (-0.5)	2.5 (2.8)	1.9 (1.8)
OECD (0.55)	3.0 (2.9)	1.8 (2.1)	2.1 (2.6)	2.6 (2.8)
TCW-weighted (0.47)	1.9 (1.9)	1.5 (1.7)	1.6 (1.9)	2.1 (2.3)
World (1.00)	4.9 (5.0)	3.9 (4.2)	3.9 (4.4)	4.2 (4.5)

Note. The figures in parentheses indicate the global purchasing-power adjusted GDP-weights, according to the IMF, 2010.

CPI	2010	2011	2012	2013
Euro area (HICP)	1.6 (1.6)	2.4 (2.7)	1.5 (1.6)	1.6 (1.8)
USA	1.6 (1.6)	3.2 (3.2)	2.2 (2.4)	1.4 (1.7)
Japan	-0.7 (-0.7)	0.4 (0.1)	0.4 (0.5)	0.3 (0.7)
TCW-weighted	1.6 (1.6)	2.5 (2.6)	1.7 (1.8)	1.6 (1.8)

	2010	2011	2012	2013
Policy rates in the rest of the world, TCW-weighted, per cent	0.5 (0.5)	0.8 (1.0)	1.0 (1.6)	1.7 (2.7)
Crude oil price, USD/barrel Brent	80 (80)	111 (112)	109 (111)	106 (108)
Swedish export market	8.8 (8.8)	7.0 (8.2)	5.3 (6.7)	5.2 (6.4)

Note. The Swedish export market index is calculated as a weighted average of the imports of the 15 countries which are the largest recipients of Swedish exports. They receive approximately 70 per cent of Swedish exports. The weight assigned to a country is its share of Swedish exports of goods.
Sources: Eurostat, IMF, Intercontinental Exchange, OECD and the Riksbank

Table 5. GDP by expenditure
Annual percentage change, unless otherwise specified

	2010	2011	2012	2013
Private consumption	3.4 (3.4)	2.0 (2.4)	1.9 (2.2)	2.3 (2.2)
Public consumption	2.5 (2.5)	1.0 (1.5)	0.6 (0.7)	0.7 (0.7)
Gross fixed capital formation	7.1 (7.1)	7.9 (8.7)	6.0 (6.7)	5.8 (5.6)
Inventory investment*	2.1 (2.1)	0.6 (0.3)	-1.0 (-0.8)	-0.1 (0.0)
Exports	11.0 (11.0)	8.4 (9.3)	4.4 (5.5)	5.6 (5.9)
Imports	12.8 (12.8)	6.7 (8.3)	3.8 (5.0)	6.2 (6.5)
GDP	5.7 (5.7)	4.5 (4.4)	1.7 (2.2)	2.4 (2.5)
GDP, calendar-adjusted	5.4 (5.4)	4.5 (4.4)	2.1 (2.6)	2.4 (2.5)
Final figure for domestic demand*	3.7 (3.7)	2.7 (3.1)	2.1 (2.5)	2.4 (2.3)
Net exports*	0.0 (0.0)	1.2 (1.0)	0.6 (0.6)	0.1 (0.1)
Current account (NA), per cent of GDP	6.2 (6.2)	6.4 (6.4)	6.7 (6.7)	6.4 (6.5)

*Contribution to GDP growth, percentage points
Note. The figures show actual growth rates that have not been calendar-adjusted, unless otherwise stated. NA is the National Accounts.
Sources: Statistics Sweden and the Riksbank

Table 6. Production and employment
Annual percentage change, unless otherwise stated

	2010	2011	2012	2013
Population, aged 16–64	0.5 (0.5)	0.2 (0.3)	0.1 (0.1)	0.0 (0.0)
Potential hours worked	0.9 (0.9)	0.5 (0.5)	0.4 (0.4)	0.3 (0.3)
GDP, calendar-adjusted	5.4 (5.4)	4.5 (4.4)	2.1 (2.6)	2.4 (2.5)
Number of hours worked, calendar-adjusted	1.7 (1.7)	1.7 (1.7)	0.9 (1.2)	0.6 (0.7)
Employed, aged 15–74	1.0 (1.0)	2.1 (2.5)	0.6 (1.0)	0.5 (0.5)
Labour force, aged 15–74	1.1 (1.1)	1.2 (1.3)	0.2 (0.3)	0.1 (0.2)
Unemployment, aged 15–74 *	8.4 (8.4)	7.5 (7.4)	7.2 (6.7)	6.9 (6.4)

* Per cent of labour force
Note. Potential hours refers to the long-term sustainable level for the number of hours worked.
Sources: Statistics Sweden and the Riksbank

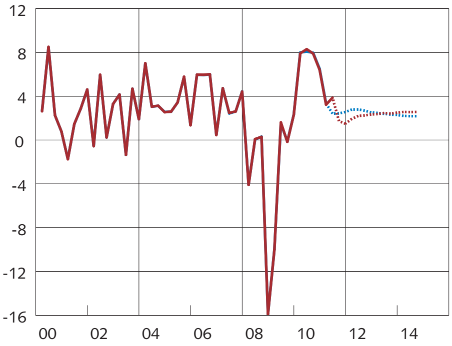
Table 7. Wages and unit labour cost for the economy as a whole
Annual percentage change, calendar-adjusted data

	2010	2011	2012	2013
Hourly wage, NMO	2.6 (2.6)	2.7 (2.9)	3.1 (3.3)	3.4 (3.5)
Hourly wage, NA	1.3 (1.3)	3.8 (3.9)	3.3 (3.6)	3.6 (3.8)
Employer's contribution*	-0.3 (-0.3)	-0.4 (-0.1)	0.1 (0.1)	0.0 (0.0)
Hourly labour cost, NA	1.0 (1.0)	3.4 (3.8)	3.3 (3.6)	3.6 (3.8)
Productivity	3.6 (3.6)	2.8 (2.6)	1.2 (1.5)	1.7 (1.8)
Unit labour cost	-2.5 (-2.5)	0.7 (1.1)	2.1 (2.1)	1.9 (1.9)

* Contribution to the increase in labour costs, percentage points.
Note. NMO is the National Mediation Office's short-term wage statistics and NA is the National Accounts. Labour cost per hour is defined as the sum of actual wages, collective charges and wage taxes divided by the seasonally adjusted total number of hours worked. Unit labour cost is defined as labour cost divided by seasonally adjusted value added at constant prices.
Sources: National Mediation Office, Statistics Sweden and the Riksbank

Figures

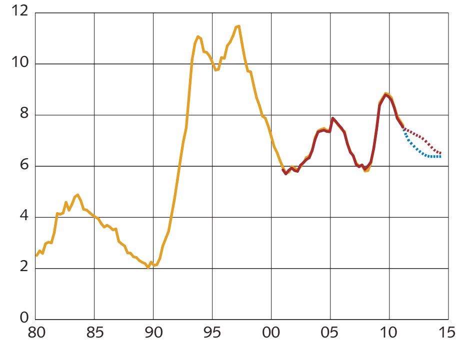
Figure 5. GDP
Quarterly changes in per cent calculated in annualised terms, seasonally-adjusted data



September
July

Sources: Statistics Sweden and the Riksbank

Figure 6. Unemployment
Percentage of the labour force, seasonally-adjusted data

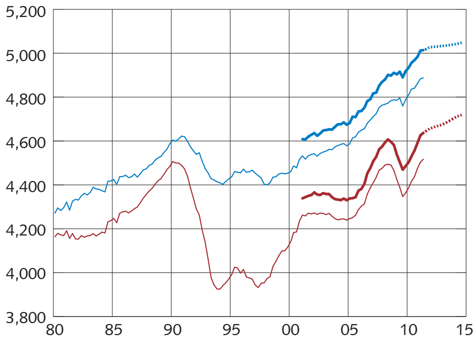


Unemployed, aged 15–74
Unemployed, aged 16–64
September
July

Note. Pre-1987 data have been spliced by the Riksbank.

Sources: Statistics Sweden and the Riksbank

Figure 7. Labour force and number of employed
Thousands, seasonally-adjusted data

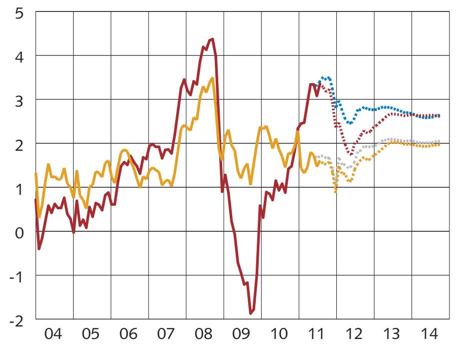


Employed, aged 16–64
Labour force, aged 16–64
Employed, aged 15–74
Labour force, aged 15–74

Note. Pre-1987 data have been spliced by the Riksbank.

Sources: Statistics Sweden and the Riksbank

Figure 8. CPI and CPIF
Annual percentage change

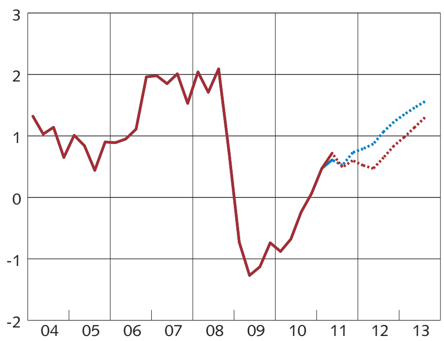


CPI, September
CPIF, September
CPI, July
CPIF, July

Note. The CPIF is the CPI with a fixed mortgage rate.

Sources: Statistics Sweden and the Riksbank

Figure 9. Real repo rate
Per cent, quarterly averages

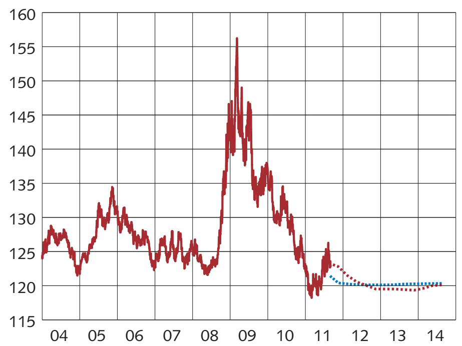


September
July

Note. The real repo rate is calculated as an average of the Riksbank's repo rate forecasts for the coming year minus the inflation forecast (CPIF) for the corresponding period.

Source: The Riksbank

Figure 10. TCW-weighted exchange rate
Index, 18 November 1992 = 100



September
July

Note. Outcome data are daily rates and forecasts are quarterly averages.

Source: The Riksbank

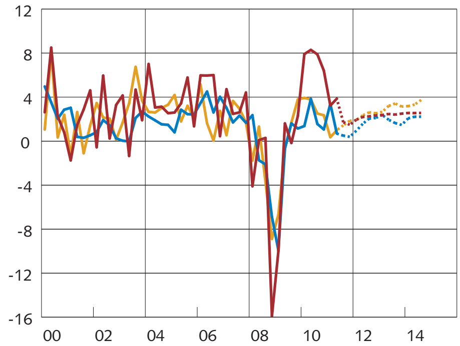
Figure 11. Oil price, Brent crude
USD per barrel

Oil price, outcome
Futures, average up to and including 1 September 2011
Futures, average up to and including 29 June 2011

Note. Futures are calculated as a 15-day average.
Outcomes represent monthly averages of spot prices.

Sources: Intercontinental Exchange and the Riksbank

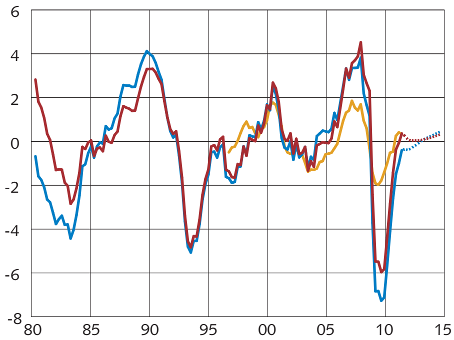
Figure 12. GDP in different regions and countries
Quarterly changes in per cent calculated in annualised terms, seasonally-adjusted data



Sweden
Euro area
USA

Sources: Bureau of Economic Analysis, Eurostat, Statistics Sweden and the Riksbank

Figure 13. GDP gap and RU indicator
Per cent and standard deviation

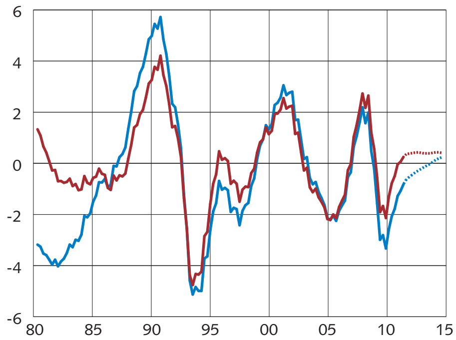


GDP (HP)
GDP (PF)
RU indicator

Note. GDP gap (HP) refers to the deviation from trend in GDP calculated with a Hodrick-Prescott filter. GDP gap (PF) refers to the deviation from trend in GDP calculated with a production function. The RU indicator is normalised so that the mean value is zero and the standard deviation is 1.

Sources: Statistics Sweden and the Riksbank

Figure 14. Hours gap
Per cent

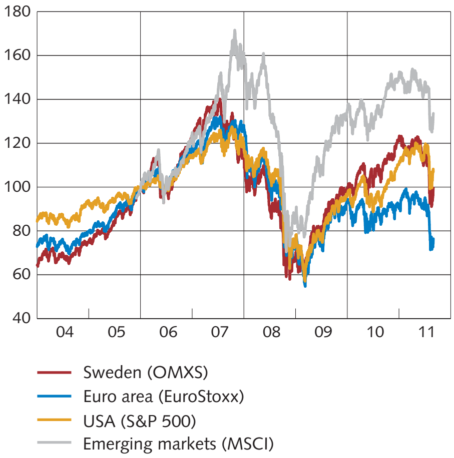


Hours gap (HP)
Hours gap

Note. The hours gap (HP) refers to the deviation from trend in the number of hours worked calculated with a Hodrick-Prescott filter. The hours gap refers to the deviation in the number of hours worked from the Riksbank's assumed trend for the numbers of hours worked.

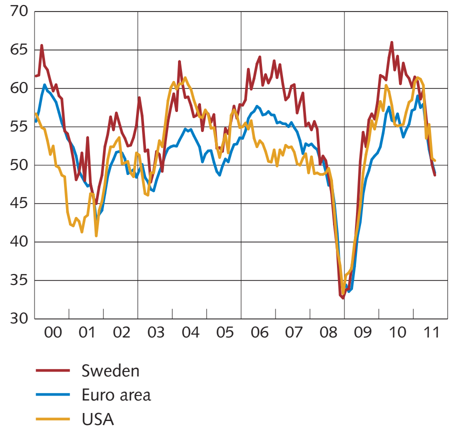
Sources: Statistics Sweden and the Riksbank

Figure 15. Stock market developments
Index, 3 January 2006 = 100



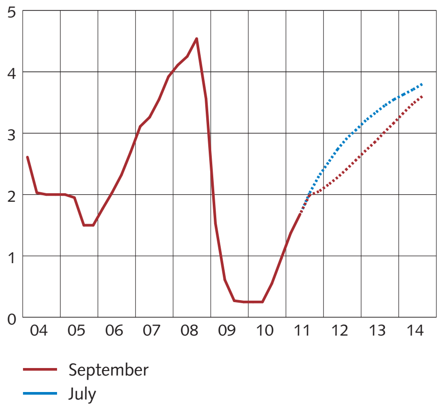
Source: Reuters EcoWin

Figure 16. Purchasing managers' index, manufacturing sector
Index, over 50 indicates growth



Sources: Institute for Supply Management, Markit Economics and Swedbank

Figure 17. Repo rate
Per cent, quarterly averages



Source: The Riksbank