

1996.08.15

## **Opening remarks by Mr. Urban Bäckström, Governor of Sveriges Riksbank, at the press conference on August 15th, 1996**

### **Interest rate corridor lowered 0.5 percentage points**

- *The Riksbank has decided today to lower its deposit and lending rates, in both cases by 0.5 percentage points. The deposit rate is set at 4.75 per cent and the lending rate at 6.25 per cent. The decision is effective from August 21th, 1996.*
- *The information that has been published during the summer, for instance about the development of prices and economic activity in Sweden, is in line with the main scenario that was presented in the Riksbank's inflation report last June.*
- *During 1996 the repo rate has been lowered comparatively quickly. The pace of the Riksbank's recent cuts has been somewhat slower. It is essential that the conditions for future monetary policy are carefully analysed in the light of incoming information. There may still continue to be some room for easing the monetary stance.*

### **Increased stability improves conditions for sustainable growth**

Low inflation is a means of creating conditions for growth and employment. Every lengthy period of high, stable growth and employment in Sweden has been conditioned by low inflation. An unambiguous inflation target serves to stabilise

expectations about economic policy. If the central bank acts with its instrumental rate in such a way that the target is attained, the credibility of the low inflation policy will be strengthened by degrees.

It is a monetary policy paradox that the greater the credibility of economic policy achieving and maintaining low inflation, the greater will be the possibilities of also according weight to aspects of growth in the short run. The converse also holds. The greater the weight a central bank is known to accord to short-run stimulation of growth, the smaller are the possibilities of promoting high and stable employment. Inflation expectations are also liable to move up, which may lead to rising interest rates, a weaker exchange rate and increases in prices and wages. Attempts to augment demand when inflation expectations are high lead to increased inflation rather than to growth.

The advantages of keeping inflation in check have been particularly evident in the past six months. In connection with international slowdowns in the 1970s and '80s, the Swedish economy was frequently in a situation of high and rising inflation. That tended to accentuate the economic downturn.

Today, the low inflation has provided a better starting point. During the spring the Riksbank has been able to lower the repo rate relatively quickly. Exact comparisons over long periods are always difficult but it does seem that the Riksbank's instrumental rates have come down to the levels in the 1950s and '60s.

In recent years important results have been achieved in bringing the Swedish economy onto a path with a longer period of lastingly high growth and employment while keeping inflation low. There has also been a reassessment of Swedish economic policy and the Swedish economy in financial markets. With the increase in macroeconomic stability, conditions have been improved for sustainable growth and employment. While this does not mean that the adjustment is complete, the Swedish economy has made good progress in that direction.

- Sweden is now in the fourth year of economic growth after the deep and grave recession in the early 1990s. Since the upturn in the summer of 1993, growth in annual terms has averaged around 2.5 per cent. A comparison shows that this is much the same rate as during the upswing in the early 1980s. Preliminary figures from Statistics Sweden suggest, moreover, that growth continued in the spring of 1996, albeit at a somewhat weaker rate.
- The difference from the 1980s, as well as from the '70s, is that inflation has been substantially reduced. Price movements now display a trend that corresponds to a good European level. Households, firms, parties in the labour market and agents in

financial markets are becoming increasingly prone to count on inflation remaining low.

- The deficit in public finance is diminishing by degrees and faster than most observers expected. There is also considerable political agreement about the target of achieving balance not later than 1998. The current account shows a large surplus.

### **The conditions for monetary policy**

The rate of inflation (measured with the consumer price index) in July 1996 was 0.6 per cent. The krona's appreciation in the past year and falling house mortgage rates have subdued the rate of inflation but these effects are judged to be mainly transient. The rate of domestic inflation (the change in the CPI that does not come from imported goods or house mortgage interest costs) was 1.9 per cent in June and it has been stable around 2 per cent for some time. Still, the latest inflation figures are somewhat lower than the Riksbank counted on in the most recent inflation report.

The central consideration in the construction of monetary policy is assessments of future inflation. The main factors in such an analysis are:

- Inflation expectations
- The exchange rate tendency
- The demand situation and supply factors

*Inflation expectations* have developed favourably. In recent months they have gone on falling and are around the inflation target, for some groups even below this.

The *krona* has continued to appreciate during the summer but there was some recoil at the beginning of August. For the assessment of future inflation - and thus for the construction of monetary policy - what matters is the more lasting tendencies. Considering the Swedish economy's improved stability, a reasonable starting point is that the krona will continue to adjust to its equilibrium level.

The *demand situation* in the Swedish economy in the winter and spring has been marked by weaker international activity in Europe and downward stock adjustment in Sweden.

The international economic situation is varied. Activity is strong in the United States, the United Kingdom and Norway. The Japanese economy is steadily improving. Development has been weak, on the other hand, in several European countries, though there are now some signs of better activity in Germany, for example. It is reasonable to count on a recovery, though its strength and timing are still uncertain.

In Sweden, economic growth this spring, judging from preliminary figures from Statistics Sweden, amounted to 1.5 per cent from the first half of 1995. Gross fixed investment and net exports both contributed to this. There was also some increase in private consumption.

It is still too early to draw any definite conclusions about the course of activity in the Swedish economy, although a stabilisation and possibly some recovery is discernable. This in turn may imply that the risk, discussed in the June inflation report, of a scenario with considerably weaker demand than in the main alternative, has decreased.

Better international activity, diminishing stock adjustments and some increase in demand from the domestic market indicate a recovery in the Swedish economy. But the economy is unlikely to reach full capacity utilisation during 1997. The stronger krona and the lower interest rate have strengthened the conditions for a more uniform activation of unutilised capacity.

During the autumn of 1996 inflation, measured by the CPI, will show some increase as the temporary effects disappear. Prices are also likely to be affected by approved increases to indirect taxes. The changes in underlying inflation, as variously measured by the Riksbank, are expected to be limited. It is conceivable that the high level of wage increases in relation to the inflation target will have some impact on the rate of inflation when domestic demand picks up.

*A weighted assessment* of the factors that determine the rate of inflation suggests that conditions are good for inflation in the coming two years being in line with the inflation target.

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