

Press Release

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Monetary policy and economic growth

Deputy Governor Kristina Persson took part in a panel discussion in Piteå on Friday, organised on the occasion of Sparbanken Nord's 150th anniversary. Mrs Persson commented on the most recent monetary policy decision and the Inflation Report published in March.

"At the Riksbank's most recent monetary policy meeting, the Executive Board decided to raise the repo rate by a quarter of a percentage point, to 4.0 per cent. This decision was based partly on incoming statistics which indicated that economic activity in Sweden and abroad has probably reached its lowest point, and partly on the assumption that inflation would be above the target level for most of the forecast period," said Mrs Persson.

"The forecast we sketch for Swedish growth up to the end of Q1 2004 entails a relatively mild slowdown in economic activity from an historical perspective. This can largely be explained by the expansionary economic policy that has had a positive influence on both consumption and investment. On the other hand, the upturn is not expected to be as strong as earlier upswings in economic activity. This is partly due to the relatively weak growth in the global market and partly to the fact that the telecommunications sector, which is an important part of the Swedish economy, will probably not recover until later in the cycle," continued Mrs Persson.

"Domestic inflation has continued to rise, and risen more than expected. This applies in particular to prices for services. There are several possible, interacting explanations for this. Resource utilisation in the Swedish economy was probably slightly higher than expected, particularly during the period 1999-2000. This in turn appears to have contributed to wages, particularly those in the services sector, increasing more than expected, which can create tension and demands for compensation from other professional groups.

"For the country as a whole, wages increased by approximately 4.3 per cent last year, according to the most recent wage statistics. Our assessment is that the rate of wage increase will also be above 4 per cent this year and next year. This is an excessively high rate of increase in relation to the productivity growth we have traditionally counted on. Higher wages and lower productivity would mean a rise in

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companies' payroll expense per unit produced, which would risk pushing up prices for consumers," said Mrs Persson.

"If economic activity improves and if nothing arises that changes the picture we have painted in the Inflation Report, the indication is that economic policy needs to be less expansionary. However, I would like to emphasise that there are still risks with regard to economic activity. Despite the fact that we have had many indications of a turnaround in the USA recently, there is still considerable uncertainty with regard to developments. There is a risk that economic activity could slow down once again, and even a risk of an even deeper downturn in the long term. The large imbalances in savings in the USA must be corrected sooner or later and if this occurs suddenly, it might trigger unease that will also have a negative effect on Europe and Sweden. The uncertainty could also increase in the wake of the continued unrest in the Middle East," asserted Mrs Persson.

"The Riksbank can use monetary policy to influence inflation via total demand. But we cannot influence the outside world and nor can we affect the production capacity of the Swedish economy. Other political sectors can do this by creating the best possible conditions for growth. During the 1990s a number of structural changes were implemented, which ought to have affected potential growth. Substantial reforms have been made in the tax, social insurance and pension systems. Deregulation, increased internationalisation, EU membership, a credible policy for low inflation and stable public finances are all factors that should have had a positive effect.

"A high growth rate also proved to be compatible with a low inflation rate for several years during the 1990s. It remains to be seen whether this can be explained primarily by the recovery following the deepest economic downturn of the post-war period at the beginning of the early 1990s and by the rapid growth of the telecommunication industry, or whether reforms, deregulation and new technology have actually had an effect on the long-term production capacity of the economy.

"Continued reforms will probably be required in many fields to create the dynamics and flexibility the Swedish economy needs to compete successfully with other regions of the world. Such reforms can ultimately improve welfare in the long term," concluded Kristina Persson.