

Press Release

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Excessive wage increases a threat to the inflation target

Deputy Governor Villy Bergström gave a speech at a meeting organised by Mora municipality on Wednesday. Mr Bergström gave an account of the Inflation Report presented in March and commented on his position with regard to monetary policy.

"The conclusion in the Riksbank's most recent Inflation Report was that growth prospects in the world around us have improved and that the effects of the expansionary monetary and fiscal policy have become more evident. The slowdown in economic activity appears to be limited. At the same time, we noted that there were factors which hamper a recovery. This applies primarily to developments in the USA, where the initially low savings level indicates a cautious increase in consumption. Developments on the stock market could also provide cause for concern. In Sweden, too, the statistics indicate that the slowdown has reached its lowest point. An expansionary economic policy will contribute to a strong development in households' disposable income during the forecast period, which will have a favourable effect on consumption," said Bergström.

"From the picture outlined in the Inflation Report we can conclude that growth in the Swedish economy has been relatively good and will remain so. The downturn in economic activity last year may turn out to have been the mildest in over 30 years, employment showed a strong development and unemployment declined. The major problem is that inflation has been above the Riksbank's target of 2 per cent for some time now. This can be explained to a certain extent by various types of supply shock, which have pushed up prices on, for instance, electricity, meat, fruit and vegetables. However, even if these price increases are excluded, the inflation rate has risen. In the Inflation Report we indicate a number of factors that could have interacted and caused the rise. Resource utilisation appears to have been slightly higher than expected, judging by both developments on the labour market and inflationary pressure. This is probably an explanation why wages have increased more than expected. The statistics on wages received so far show that the average rate of wage increase for 2001 was 4.3 per cent. At the same time, productivity has weakened, which has meant that payroll expense has risen considerably. Companies have been able to partly counteract increased costs by reducing their profit margins in recent years. The current relatively low profit

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margins should entail there being no more scope for this action, which raises questions regarding resource utilisation, inflationary pressure and the functioning of the economy, as we have also pointed out in the Inflation Report. The Riksbank's total risk-adjusted assessment was that prices measured as underlying inflation, UNDEX, would increase by 2.3 per cent a year one to two years ahead," said Bergström.

"The majority of the members of the Executive Board decided to raise the repo rate by 0.25 percentage points. However, I chose to enter a reservation against this decision and would have preferred to see a hike of 0.50 percentage points. On the basis of the inflation forecast for both one and two years ahead, there was motivation for a change in the interest rate of 0.50 percentage points, and as you can see in the minutes of the meeting, several members of the Board agreed with this assessment. The reason why I decided to enter a reservation against the decision was primarily my concern over developments on the labour market. A productivity increase of approximately 1.5 per cent and an inflation target of 2 per cent would provide scope for wage increases of no more than 3.5 per cent at normal profit levels. According to the assessment in the Inflation Report, wages will continue to increase by more than 4 per cent a year, a rate that is incompatible with the inflation target. At the same time, the wage increases show large differences between the various sectors and between different professional categories. Particularly large wage increases can be noted in the services industries, which indicates an imbalance. In manufacturing, wages for white-collar workers have increased more rapidly than those of blue-collar workers. This, together with considerable problems in attracting qualified personnel to certain areas of the public sector, risks triggering demands for compensation and increasing the wage drift, especially in a situation where economic activity improves. Given this, I considered there was good reason to raise the repo rate by 0.50 percentage points to give a clear signal that the Riksbank does not intend to put the inflation target at risk," continued Bergström.

"Judging by the inflation expectations expressed in the pricing on the fixed income market, expectations were also clearly above the target level. I also considered there to be a risk with waiting too long to raise the rate. I compared the monetary situation in summer 2001 with the present situation. The repo rate was then higher than it is today, despite the fact that economic prospects were poorer and wage formation was not considered to comprise any threat to inflation. Since our most recent monetary policy meeting, there has been no new information that has changed the picture of the economy in any tangible way," concluded Villy Bergström.