Press Release

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The economic situation

First Deputy Governor Lars Heikensten spoke on Tuesday under the heading "The economic situation" at a seminar arranged by the Swedish Taxpayers Association. Among other things, he commented on developments since the latest Inflation Report was published on 19 March.

"In the Inflation Report the Riksbank presented almost a month ago we counted on a successive economic recovery in the rest of the world during the year. Growth in Sweden was judged to turn upwards too, with a rate of 1.6 per cent this year followed by 3 per cent in 2003. Inflationary pressure was accordingly also expected to grow in time," Mr Heikensten said. "Another item in the Report was that we counted on inflation falling back in the spring, though not as much as we had foreseen earlier. The relatively high underlying inflation, together with higher wage increases last year, suggests that there is less unutilised capacity than expected earlier. In the Report's main scenario, the rates of both CPI and UND1X inflation were calculated to be 2.2 per cent one year ahead, followed by 2.4 and 2.2 percent, respectively, after two years. Against this background we decided to raise the instrumental rate 0.25 percentage points to 4.0 per cent," Mr Heikensten said.

He then considered three questions that have been raised in the discussion that followed the repo rate decision:

"1. Why did the Riksbank raise the repo rate so soon and before many other central banks?
In the light of our forecast, the decision was natural. Our decisions are based, not on what others do, but on an assessment of inflation in Sweden, primarily 1–2 years ahead. Inflation in the relevant perspective was too high, regardless of whether we measured it with the CPI or UND1X. Inflation in Sweden does in fact resemble the picture abroad in some respects, not least the relatively high rate of price increases in the services sector. But compared with other countries, the underlying pressure from costs is higher in Sweden, particularly in terms of wage increases. For a number of years the latter rate has been around one percentage point higher than in the major euro countries, for example. Against this background it is not all that surprising that we raised the repo rate now and have a higher level of interest rates, particularly as fiscal policy is also more expansionary and the exchange rate is still rather weak.

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"2. Why raise the repo rate when a future fall in inflation is foreseen?
The Riksbank believes that during the spring inflation will move down towards 2 per cent. In this respect we do not differ all that much from most other observers. A part of last year's increase in inflation can be explained by supply shocks. There are still good reasons for supposing that their effects will drop out of the statistics during the spring. What worries us is the additional, more trendwise increase in underlying inflation. Furthermore, our primary focus is, of course, on what will happen 1–2 years ahead. So what happens with inflation in the near future is not so crucial for our actions as long as it does not affect our more fundamental view of how the economy functions, its inflation propensity and so on.

"3. Hasn't there been an about turn in the Riksbank's assessment?
It is true that our appraisal of inflation has become somewhat more pessimistic and that this has shown up more clearly in the latest Report. But it cannot be described as an about turn. The Riksbank had already warned that the risks of inflation could be greater than we believed when inflation moved up unexpectedly last spring. In the May Report, for example, we wrote that 'The risks for inflation connected with domestic demand and the relationship between growth and inflation in Sweden are somewhat more on the upside than foreseen in the March Report. It is conceivable that the higher registered inflation is partly a sign that resource utilisation is more strained than assumed in the main scenario.' Since then we have lived with and communicated this concern, which has coloured our overall assessments of inflation. In this way there has been a clear effect on monetary policy; the level of our interest rates has crept up relative to the rest of the world," Mr Heikensten said.

In conclusion, he commented on what has happened since the March Report was published. "On the whole I consider that the Report's picture of international activity has been confirmed. Data from the United States have perhaps been marginally stronger than expected but do not warrant more than marginal changes in the appraisal of international growth. The data for Sweden are likewise in line with the earlier assessment. While inflation in the past month was somewhat higher than expected, the domestic component was somewhat lower than in the previous month. By themselves, these figures do not call for changes in the more fundamental picture of inflation but of course they are pieces in the puzzle we put together. The oil price rise is naturally a cause for concern but it should be born in mind that it directly affects not just inflation but also disposable income and thereby aggregate demand. Moreover, the oil price rise is intimately bound up with political unrest, so the net effect that current developments may have on inflation 1–2 years ahead is not self-evident," Mr Heikensten continued.

"All in all, I do not think there are reasons at present for appreciably altering the assessment of inflation we presented in the March Report and registered in the minutes of the monetary policy meeting on 18 March," Mr Heikensten concluded.