

Press Release

13 MAY 2002 NO 24

Lars Nyberg: International upturn and wage developments behind interest rate hike – absence due to sick leave constitutes problem

Deputy Governor Lars Nyberg held a speech at a meeting arranged by Pressens pensionskassa (the press superannuation fund) on Monday. Mr Nyberg commented on the motives behind the two repo rate hikes this spring and expressed two important reasons for conducting a less expansionary monetary policy; the broad international upswing in economic activity and developments in wages and prices in the services sector in Sweden.

“In recent weeks the news reports and economic debate in Sweden have been marked by the concern over Ericsson’s interim report and the company’s announcement of staff cutbacks, as well as the decline on the Swedish and foreign stock markets. At the same time, the Riksbank’s assessment is that inflation will fall in the near future from the previous high levels. Nevertheless, the Executive Board of the Riksbank chose on 25 April to raise the repo rate for the second time this spring, by 0.25 percentage points to 4.25 per cent.

“First of all, it is important to remember that it is not merely the repo rate that has an effect on growth in demand. The real interest rates facing households and companies on the credit market are low. The krona is clearly undervalued. Fiscal policy is providing a substantial contribution to households’ purchasing power through increased transfers and lower taxes. The total economic policy has an expansive effect on demand.

“What the Riksbank has done this spring is more a case of easing up on the monetary policy accelerator rather than putting on the brakes. The repo rate has been adjusted back to the level prevailing prior to the cut of 0.5 percentage points following the events of 11 September. This cut can with hindsight be regarded as well-motivated, because international economic activity weakened significantly as a result of the terrorist acts and the downside risks increased. 2001 was characterised by a division of the Swedish economy into a weak export sector and a stronger domestic services sector.

“Today the situation is rather different. During the course of the spring the Riksbank’s picture of a stronger international economic climate has been gradually

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confirmed by incoming statistics and forward-looking surveys on Sweden's most important export markets, in particular the USA. However, the Riksbank still believes in a fairly tentative recovery, partly because the low level of household savings in the USA is expected to rise. Although even if the upturn is fairly modest, global trade is expected to recover from the decline in 2001, which will have great significance for the Swedish export industry," asserted Mr Nyberg.

"It may appear that this scenario contrasts with the recent weak developments on the stock markets. However, the decline followed on from previously very high expectations of the stock markets. The Riksbank has taken a more cautious view of international developments, and it is important to remember that the current share prices in the USA, even after the decline, reflect expectations of considerable improvements in profits. The factor that has deteriorated future prospects in Sweden is the telecommunications products sector, where the crisis looks to be more prolonged than expected. However, this sector is only a small, albeit important, part of Swedish trade and industry with regard to employment and value added. All in all, the broad international upturn is the dominant factor and will gradually lead to an increase in the already high resource utilisation in the Swedish economy, through increased exports.

"Another important reason for the decision to conduct a slightly less expansionary monetary policy is, of course, the developments within the sector that has remained strong during the entire economic downturn, namely the services sector. Wages and prices in this sector appear to have risen rather more quickly than is sustainable in the long term. The lack of personnel in certain parts of the services sectors, particularly in the public sector, but also in banking and insurance, the wholesale and retail trades, and the hotel and restaurant industry, may force up wages even further. There is a risk that these wage increases will be shifted over into rising prices as companies' profit margins have already been squeezed considerably and productivity weakened during the economic downturn.

"A related problem is the rise in absence due to illness that is putting further strain on the labour market. A central issue for the Riksbank is whether the increased sick leave is due to economic or structural reasons. It is difficult to give a definite answer this question, which needs further study. We have seen that in a historical perspective, absence due to illness has tended to increase, with some time lag, when the Swedish economy has been under great pressure. Of course, the levels of compensation for sick leave and unemployment benefit could also have some significance. If an increase is due to cyclical factors, it is possible that the rise in absence we are observing now is a consequence of the boom period 1999-2000, an effect that will gradually abate, leaving the absence level to fall back to the earlier level. On the other hand, if a large part of the absence is due to structural reasons (if, for instance, sick leave is more systematically being allowed to supersede or replace unemployment benefit, or if sick leave is increasingly followed by early retirement), it comprises a more fundamental problem for the Swedish labour market, with a greater risk of a labour shortage. If this is the case, it reinforces the concern regarding wage developments in the services sector and more generally in the Swedish economy. The truth probably lies somewhere between these two explanations."

“Since the previous Inflation Report the international upturn has been confirmed but share prices have fallen, oil prices have risen and security policy uncertainty has increased. At the same time, the Riksbank has raised the steering interest rates and market rates have also risen. All in all, it is reasonable that these factors should contribute to a slightly more subdued rise in demand than was assumed in the March Inflation Report. However, a total assessment of future inflation remains, which the Riksbank will include in the next Inflation Report.”