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Main features of the inflation assessment still apply

Speaking on Wednesday at a seminar in the Riksdag (Sweden's parliament) on "Current monetary policy issues", First Deputy Governor Lars Heikensten commented on economic developments and the situation for monetary policy.

"Developments abroad and in Sweden have broadly followed the scenario on which the latest monetary policy decisions were based. Growth in the rest of the world has been in line with the forecast in the March Inflation Report, while demand in Sweden seems to be following a somewhat weaker path than assumed at that time. Inflation in Sweden has fallen back, as expected, and there are grounds for counting on a further fall in the coming months. But as economic activity improves in the years ahead, it is reasonable to foresee some renewed increase in inflation," Mr Heikensten said.

"Since the March Report, the signs of an international economic upswing have been largely confirmed. The improved prospects for growth in the United States are judged to contribute to a recovery in Europe, although the tendency is being checked to some extent by, for example, a persistently weak labour market and subdued real wage growth. The price of oil, which has risen since the March Report, can be assumed to fall back successively from the current high levels. But in conjunction with the Swedish krona's somewhat weaker exchange rate, the oil price rise may still contribute to a short-term increase in imported inflation that is somewhat greater than expected," Mr Heikensten said.

"I cannot see any reason at present to revise the GDP forecast for Sweden at all substantially. Most things still point to economic activity rising cautiously in the course of this year, followed by fairly robust growth in 2003. Industrial activity seems to have become somewhat stronger; indicators such as output, incoming orders and various measurements of confidence in the future support such an interpretation. Moreover, the weaker exchange rate favours production for export. A recovery also seems to be on the way for households, though the signs of this are not quite as clear. Indicators that point in this direction are consumer confidence, retail turnover, car registrations and demand for notes and coins. Contrary signs are monetary policy's less expansionary direction and higher market interest rates. The unsettled stock market tendency is also tending to subdue consumption and investment. All in all, against this background there are grounds for supposing that demand will be somewhat weaker than assumed earlier. This means that, compared with the assessment in the March Inflation Report, resource utilisation in the forecast period will be marginally lower," Mr Heikensten said.

"In April the 12-month rate of CPI inflation was 2.5 per cent and UND1X inflation was 2.8 per cent. Effects of various supply shocks, which contributed to transiently higher prices last year for energy and certain food products, for example, have receded as forecast in March and helped to lower inflation somewhat. A further fall is likely in the coming months but it probably will not be quite as marked as the Riksbank counted on last year. Moreover, there is reason to count on some renewed increase in inflation as economic activity picks up. Most things suggest that total resource utilisation is already comparatively high, though there are considerable differences between sectors. This implies that in the years ahead, wage increases – even if they are lower than last year – may be relatively high. Productivity will presumably improve to some extent when activity turns upwards but this is unlikely to make up in full for the high wage increases. As the profit share is relatively low, a part of the increased costs will no doubt be passed on in higher prices," Mr Heikensten continued.

"There are considerable similarities between the picture of inflation in Sweden and in the euro area. Inflation rose appreciably in both cases last year, primarily due to transitory factors to do with supply. But in both cases there is also a clear element of more demand-driven inflation, mainly in the services sector. In Sweden, moreover, there are wage increases that are a percentage point or so higher than in the euro area. This in turn has been an important reason why the instrumental rate has become higher in Sweden than in the euro area during the past year," Mr Heikensten added.

"If the economic recovery continues as we expect and there are no grounds for altering the assessment of inflation prospects, there is reason to suppose that further repo rate increases may be needed. The repo rate has already been raised a couple of times. The pace at which further interest rate adjustments may be called for is still uncertain, however, and will depend as usual on incoming information and how this is interpreted," Mr Heikensten concluded.