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Reasonable to await further information

Deputy Governor Villy Bergström held a speech at JAK Members' Bank's summer seminar in Mellanfjärden on Friday. Mr Bergström gave an account of inflation targeting and commented on the debate as to whether the inflation target is too low. He also expressed his views on the current economic situation and on monetary policy.

"Most indications are that developments both abroad and in Sweden will follow the scenario estimated by the Riksbank recently. It was stated in the June Inflation Report that the signs of an international economic upturn have become more evident and this picture remains. However, there is still great uncertainty regarding international developments. The expansionary economic policy pursued in many countries can result in global market growth being stronger than assumed in the main scenario of the Inflation Report. In contrast with this are the savings imbalances being built up in the USA, which entail a risk that a more rapid adjustment of the low level of savings could lead to a slower global recovery. The effects of a sustained weak development in the stock markets and the current weakening of the dollar also comprise elements of insecurity," said Villy Bergström.

"As we stated in the Inflation Report, most indications are that there will be a tentative upturn in economic activity in Sweden this year and a relatively good level of growth next year. The wheels of industry have begun to turn and households' consumption should benefit from a positive development in incomes, relatively low real interest rates and rising property prices. The risks we perceive for the future are mainly concerned with the inflation tendencies in the Swedish economy and with wage formation. There is some uncertainty with regard to the amount of vacant resources in the economy, for instance, access to labour in the near future and productivity growth in certain sectors. According to the Inflation Report, inflation is expected to be in line with the target level in two years' time, but this is partly due to an expected appreciation of the krona and to an assumption that oil prices will fall, which will keep down inflation. As the effects of these two factors are toned down and growth accelerates, inflation will rise," continued Mr Bergström.

"A number of analysts have claimed in the monetary policy debate that the Riksbank's inflation target has been set too low at 2 per cent and that a target of,

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for instance, 4 per cent would be compatible with lower unemployment. With the same rate of wage increase in both the non-competitive and competitive sectors, the average inflation rate would not remain at 2 per cent, as productivity growth in the non-competitive sector, which comprises approximately 2/3 of the total economy, is relatively low, according to the critics. However, even if the non-competitive sector's growth in productivity is only one-third of the competitive sector's, it is fully possible to attain the inflation target for the Swedish economy if wage increases are limited to 3.5 per cent a year in both sectors. Prices will then rise twice as quickly in the non-competitive sector, but on average inflation would be limited to 2 per cent," declared Mr Bergström.

"Changing inflation target is not possible for an individual country that is trying to build up confidence in a low inflation economy, and nor is it necessary if wage formation is aimed towards a wage cost increase of approximately 3.5 per cent a year, i.e. real wage rises corresponding to long-term productivity growth. The problem is that the labour market does not appear able to manage this. Last year, wages rose by an average of 4.3 per cent, according to preliminary statistics. The forecast in the most recent Inflation Report was for wages to continue to rise by over 4 per cent a year, which is not motivated on the basis of productivity developments and means that companies' profits and scope for investment will be reduced. Wage cost developments are not compatible with the inflation target. Further interest rate increases may be required to give a clear signal that the Riksbank does not intend to put the inflation target at risk. On the other hand, international developments are currently rather more uncertain than I assessed them to be at the previous monetary policy meeting. This would indicate that there may be reason to wait a while before raising interest rates again, to ensure that the Riksbank's assessment still holds true" concluded Villy Bergström.