

Press Release

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The current situation for the Swedish economy

Deputy Governor Kristina Persson today held a speech at a meeting in Habo, Jönköping county, organised by Förenings Sparbanken, the Federation of Private Enterprises and the Swedish Shareholders' Association on the theme of "What is the situation for the Swedish economy?"

"As yet there are no definite signs of a stable economic upturn. The Riksbank has made a downward revision to its forecasts for growth and inflation in Sweden over the next one to two years," said Kristina Persson.

"Developments in Sweden are strongly dependent on what happens in the world around us. The US economy in particular has influence because of its size and flexibility over fluctuations in the global economy. Many analysts, including the Riksbank, had anticipated that economic activity would show a more evident upturn during 2002. The effects of 11 September appeared to have been limited in the USA, largely thanks to the powerful stimulation from both monetary policy and fiscal policy. Household demand and the housing market contributed to bridging over the downturn. The important question we all ask ourselves is whether it is really sufficient to lever the global economy into a stable upturn," continued Mrs Persson.

"From the summer onwards, expectations of an economic upturn during 2002 have been subdued. The rises on stock markets in recent weeks could be an indication that optimism has returned, but it is also quite possible that the substantial inflation in share prices that took place during the second half of the 1990s is still fizzing."

"Corporate scandals and the fear of war and terrorist actions around the world have contributed to a lack of confidence regarding the future, weakening the will to purchase and invest in the USA. If large parts of household savings for children's studies or for retirement pensions have been eroded it is understandable that saving will increase, particularly as indebtedness among US consumers is already high to begin with. Recent statistics from the USA also indicate a slightly weaker growth rate than expected and a small rise in unemployment," said Mrs Persson.

"Savings imbalances in the US economy are one reason why there has been a risk of the turnaround being slowed down. The federal budget has a growing deficit and both companies and households in the USA have a high level of indebtedness. The

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current account continues to show a large deficit, which makes the USA dependent on a daily inflow of capital amounting to approximately USD 1.5 billion.”

”Since the mid-1990s the deficit has been financed by a significant inflow of foreign capital attracted by the positive investment climate and expectations of continued good productivity growth. However, if the expectations of a good return should begin to waver seriously, for instance because investment in trade and industry did not pick up speed, there is a risk that the capital inflow would decline rapidly. This would entail a further depreciation of the dollar and put upward pressure on interest rates. As long as confidence in the US economy remained high, interest rates could be kept down, which favoured the housing market. If interest rates instead begin to rise, the opposite effect could be triggered. A gradual adjustment of the imbalances is unavoidable, but if it were to occur too suddenly it could affect the entire global economy.”

“Concern is reinforced by the fact that there is currently no other region or country that can act as an economic driving force. The three major players – the USA, Europe and Japan – are all into a period of low or non-existent growth, which strengthens the feeling of pessimism. Germany, which is a large and important export country for Sweden, has had a stagnating economy for the past year and other important euro countries, such as France and Italy, are also showing a slow recovery. A weak dollar will further deteriorate European export prospects,” continued Mrs Persson.

“There are other domestic reasons to believe in a slightly more subdued development in demand, such as the tax increases announced by county councils and local authorities, weaker public finances and a stronger krona. The National Institute of Economic Research’s October barometer showed a clearly weaker than expected outcome for industrial companies’ order growth and production.”

“The decision at the monetary policy meeting on 16 October was to wait and see and to hold an extra meeting on 14 November. Personally, I considered then that the forecast in the Inflation Report, together with the risk spectrum presented, provided sufficient reason to lower the repo rate by 0.25 base points, particularly as there was a risk of more serious developments in the global economy, for instance if the USA were to attack Iraq.”

“The developments of the past weeks have not given reason for any fundamental revision of my position. The conditions for the turnaround are such – both in Sweden and abroad - that it will probably be a slow and prolonged process with very little stimulation towards price increases. At the same time, the risk spectrum I described earlier exists and could very well lead to an even lower growth rate.”

“In this situation, lower interest rates may have the function of stimulating the real economy without triggering inflation. Of course, the concern earlier expressed by the Riksbank with regard to overly rapid wage increases cannot be completely discounted, but in my opinion the probability of these having a negative effect on the inflation picture over the coming 18 months is slight,” concluded Kristina Persson.