

Article: A monetary policy for effective wage formation

The Riksbank is conducting an expansionary monetary policy and is prepared to do more if the need arises. This creates the preconditions for wages and prices to rise in a way that is in line with the inflation target, and contributes to well-anchored inflation expectations. Effective wage formation makes it easier to conduct monetary policy. Similarly, wage formation becomes easier if monetary policy is consistent and credible. Monetary policy and wage formation are thus interlinked.⁵

Wages and other costs associated with labour account for a substantial proportion of production costs and are therefore of great significance when the companies set their prices. Estimating the future development of wages is therefore an important part of the inflation forecast that forms the basis for the Riksbank's monetary policy.

Assessing the rate of inflation in the period ahead is also important for other participants in the economy, for example the social partners when they negotiate wages, as inflation has an impact on real wages. There is thus a link between inflation expectations, wage formation and the actual rate of inflation. If inflation is reasonably close to the inflation target over time, the households, companies, employees and employers will expect this to remain the case in the future. The inflation target will thus become a natural starting point in price and wage formation, which in turn means that it will also be easier for the Riksbank to actually reach the target. A positive self-reinforcing process arises and the facilitation of wage formation creates the potential for a balanced development of the economy in which real wages rise in the long term in pace with productivity in the economy.

However, a precondition for the inflation target acting as a nominal anchor, that is as a stabilising factor for price and wage formation, is that inflation is not too much above or too much below the target for too long a time. This would give rise to the risk of a *negative* self-reinforcing process. If, for example, inflation is well below the target for a long period of time, expectations may adjust to the assumption that inflation will not return to the target even in the longer term. If the anchor begins to slip uncertainty will increase, and the preconditions for wage formation will deteriorate. If, for example, a company believes that its competitors will leave its prices and wages unchanged, it will find it more difficult to raise its own prices and agree to wage increases. The result is that inflation will continue to be low, which in turn will affect inflation expectations and so on.

At present, the Swedish economy is a long way from getting trapped in such a negative process. However, the risk of such a process arising has gradually increased and plays an increasingly central role in monetary policy. It is also important to act in time before problems arise.

The next large-scale round of collective bargaining will take place in 2016, when wage agreements covering around 3 million employees in the private and public sectors will expire. It will then be important that inflation expectations are anchored around the inflation target of 2 per cent, which will of course be easier if inflation is clearly approaching the inflation target when bargaining begins. According to the Riksbank's forecast, CPIF inflation will reach 2 per cent at the turn of the year 2015-2016 and then continue to rise in 2016. It is true that the inflation target is defined in terms of the CPI, not the CPIF. But in periods with major interest-rate changes, as in recent years, CPIF inflation provides a better picture of inflationary pressures than the CPI, which includes the direct effect of changed interest rates.

The Riksbank's lowering of the repo rate to –0.25 per cent and complementary measures in the form of bond purchases have been carried out to ensure that inflation rises towards the target and that long-term inflation expectations are thus compatible with the inflation target. The expansionary monetary policy contributes to lower market rates and a weaker krona, which ultimately increases inflationary pressures in the economy. By underlining the fact that the inflation takes priority in both words and action, the Riksbank is also attempting to affect inflation expectations more directly.

In this way, monetary policy attempts to *create the preconditions* for prices and wages to begin increasing in a way that is in line with the objective – to get inflation to rise in a balanced way. The inflation forecast, combined with the Riksbank's forecast for nominal wage increases implies that real wages are increasing roughly in line with productivity. In this way, the wage increases will be neither too high nor too low, but will contribute to a balanced development of the economy

The measures taken and the readiness to do more underline the Riksbank's aim to safeguard the role of the inflation target as a nominal anchor for price and wage formation

⁵ A more detailed description of this link can be found in the article "The interplay between wage formation, monetary policy and inflation" in *Monetary Policy Report*, July 2014. See also, for example, N. Gottfries, *Fungerar den svenska lönebildningen?* (Does Swedish wage formation work?), Appendix 5 to *The Long-Term Survey of the Swedish Economy 2011* and *The Wage Formation Report, 2014*, the National Institute of Economic Research.