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■ Persson: Monetary policy - experiences and thoughts on the future

Deputy Governor Kristina Persson will speak on Saturday in Luleå at a seminar arranged by Swedbank about Swedish monetary policy, experiences of inflation targeting and her views about the future.

"To begin with I shall comment on the minutes of the monetary policy meeting published at the beginning of last week. All of us on the Executive Board were agreed that it was appropriate to raise the repo rate by 25 points. The continued strong economic activity is expected to lead to rising inflation over the coming years. The repo rate will also, as we see it now, need to be raised further to attain an inflation rate in line with the target a couple of years ahead. The rate at which this should be done will depend as usual on how the economy develops in the future. At present, there is particular focus on developments in the labour market," began Ms Persson.

"There are numerous indications that there is spare capacity in the labour market. The proposals now put forward by the Government should lead to an increase in the labour supply, at least in the long term. The key to a good development of the labour market in future is that supply and demand are well matched," continued Ms Persson.

"One major challenge for both the Government and the social partners will be to enable the adjustments required for this matching to be successful. It requires a good corporate climate and willingness to invest in both knowledge and capital. Good matching also requires flexibility in the labour market so that employees can retrain as smoothly as possible, and apply to new sectors and new regions," said Ms Persson.

"The responsibility for the future development of employment and unemployment rests with the social partners and the Government. What the Riksbank can do is to conduct a well-balanced monetary policy in line with the intentions of the Sveriges Riksbank Act, so that inflation is low and stable at the same time as short-term fluctuations in the real economy do not become too large. By stabilising inflation expectations, monetary policy contributes to a more stable economic development. The Riksbank has largely succeeded in this since the inflation target was introduced," said Ms Persson.



■ "Two professors, Francesco Giavazzi and Frederic Mishkin, have examined how well the Riksbank has succeeded with the monetary policy it has conducted over the past 10 years. As the Riksbank has an independent position, it is important that monetary policy should be regularly examined and assessed. The overall conclusion of the assessment regarding Swedish monetary policy and the Riksbank was positive. However, the authors express criticism on some points, aimed at the Riksdag, the Swedish Parliament, and the Riksbank," said Ms Persson.

"In my opinion, the criticism of the Riksbank is partly justified. Giavazzi and Mishkin consider that the Riksbank should give greater consideration than has previously been given to developments in the real economy and the labour market. I agree with this. This was why I took various initiatives during the years 2002-2004 to emphasise the structural issues in the Riksbank's work. The professors also consider that our Inflation Reports should describe in more detail what the flexibility of our inflation-targeting policy entails. Although we have discussed this in various contexts, including the document "Monetary policy in Sweden", which explains how the Riksbank can give consideration to developments in employment and growth when setting interest rates, we should, in my opinion, become even better at communicating externally what this involves in practice. I also agree with Giavazzi and Mishkin that the Riksbank should publish forecasts based on its own assessment of the future repo rate instead of the technical assumption made now, which is based on the expectations of financial market agents. This is a question that has been discussed by the Executive Board for some time now," pointed out Ms Persson.

"Giavazzi and Mishkin also criticise the Riksbank because inflation has been below target in recent years. To compensate for this, inflation should, if I have interpreted their evaluation correctly, be allowed to exceed the target for a period of time. However, with a method like this, it would in my opinion be very difficult to anchor the general public's expectations of future inflation. With regard to criticising the Riksbank because inflation has been below target in recent years, I do agree that we should have cut the repo rate more quickly and at an earlier stage. However, one must remember that the causes of the low inflation rate were not linked to weak demand in the economy – that is, the conditions the Riksbank can parry with its repo rate adjustments. The low inflation was actually due to favourable supply conditions, such as surprisingly high productivity and low, even falling, import prices," continued Ms Persson.

"If the Riksbank had been able to predict developments in productivity and import prices, the improvement in the labour market would probably have got off the ground earlier. But we should not exaggerate the effects of a lower policy rate during the period 2002-2004. It is not self-evident that an even lower interest rate would have had a particularly large impact on the consumers' desire to consume and the employers' willingness to recruit," observed Ms Persson.

"When the Riksbank was formulating an inflation target at the beginning of the 1990s, we could not predict the price-dampening effects of information technology and globalisation. At that time it was particularly important to formulate a simple target that the general public could understand and accept. It was important to succeed in anchoring inflation expectations and creating substantial confidence in monetary policy. Perhaps with the knowledge we have now, we would not have decided, in my way of looking at things, to specify an exact target of 2 per cent with a tolerated deviation interval of plus/minus 1 per



cent but had used the actual interval more as the starting point; that inflation should be between 1 and 3 per cent, but that we would normally aim for 2 per cent. The difference is not particularly great, but bearing in mind that deviations from target will always exist, especially in situations where major structural changes have occurred, it would be better adapted to what can reasonably be expected from an inflation-targeting policy," concluded Ms Persson.