Monetary policy when inflation is too high – prerequisites and challenges

Swedbank (2022-12-09)

S V E R I G E S R I K S B A N K

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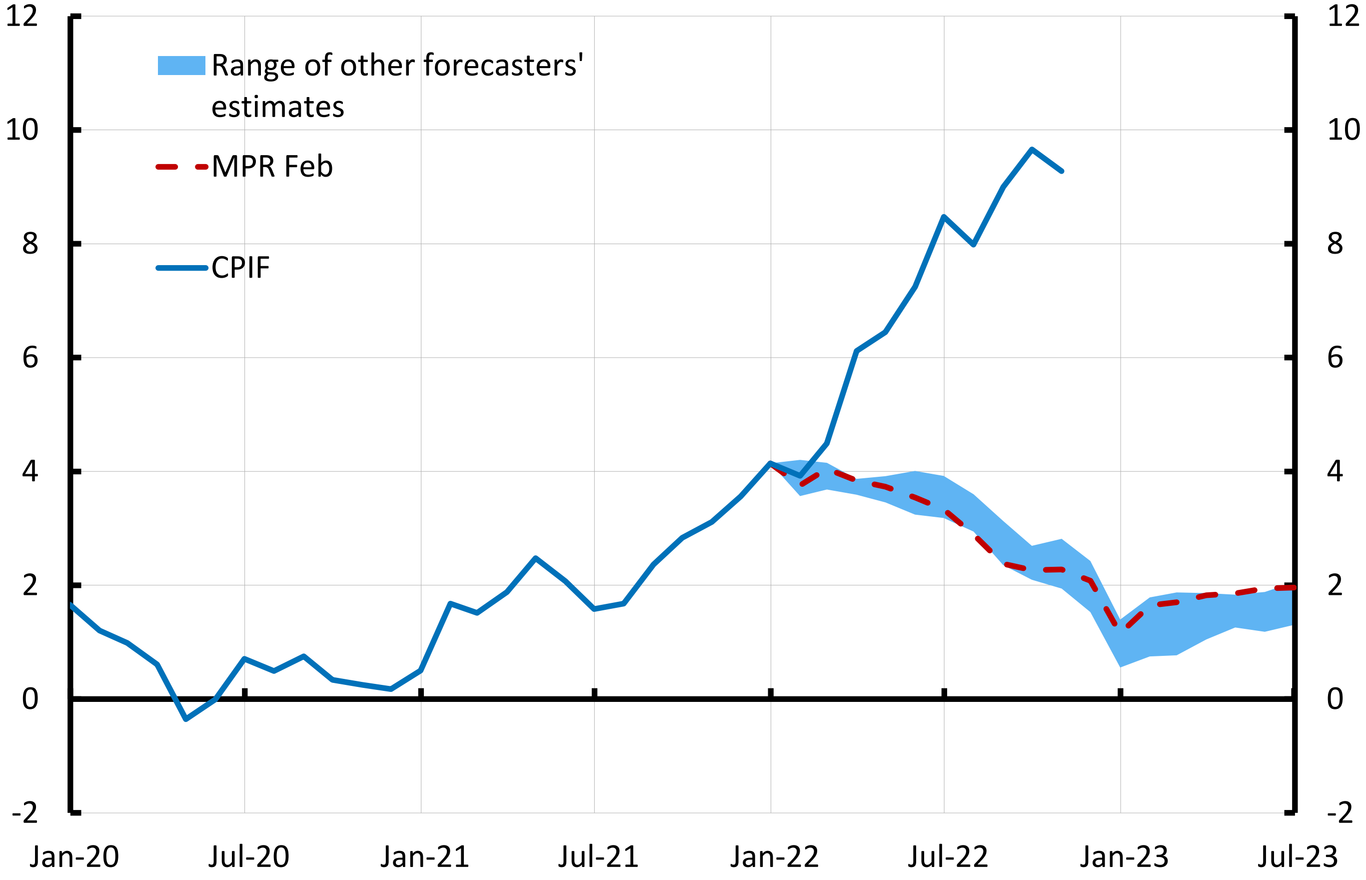
The situation has changed rapidly



Note. Annual percentage change. Refers to forecasts based on outcomes for the CPIF up to and including December 2021. The range shows the dispersion between highest and lowest estimates of other forecasters.

Sources: Statistics Sweden, individual forecasters and the Riksbank.

Two opposing types of criticism

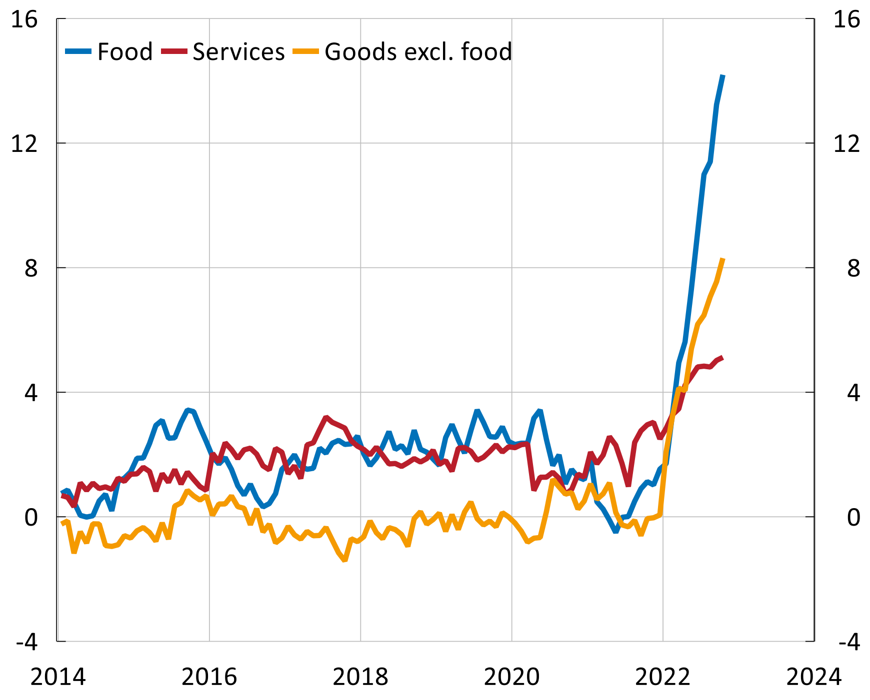
The high inflation is the fault of earlier monetary policy

- Inflationary impulses can more easily gain a foothold if demand is upheld
    - But difficult to push it further than that
- There are already convincing explanations for the upturn
- Strange transmission mechanism with an ”all-at-once” effect

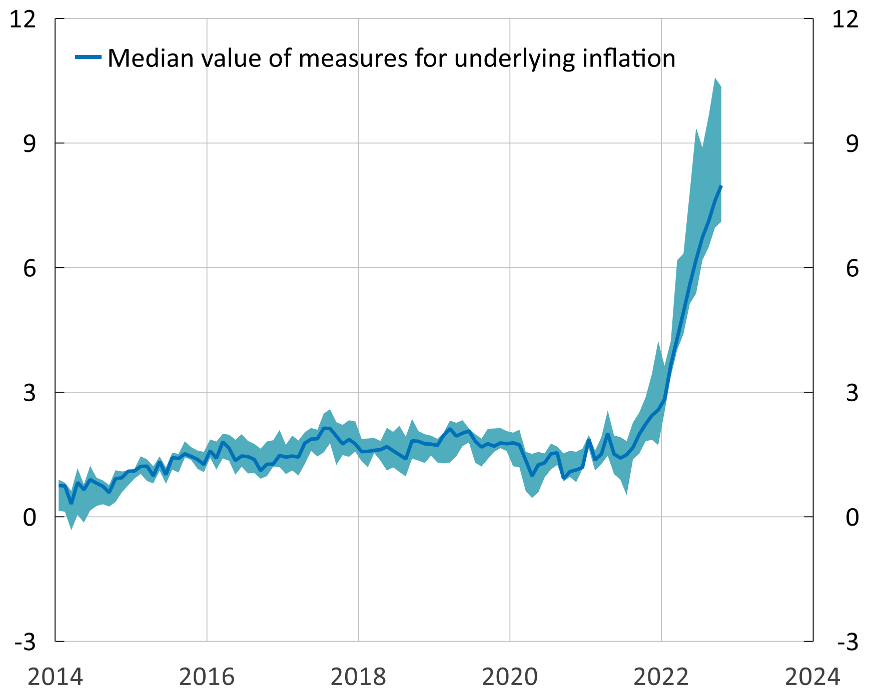
The high inflation is due solely to supply factors that monetary policy cannot do anything about

Broad upturn in overall inflation – not only energy prices

Sub-index in the CPIF



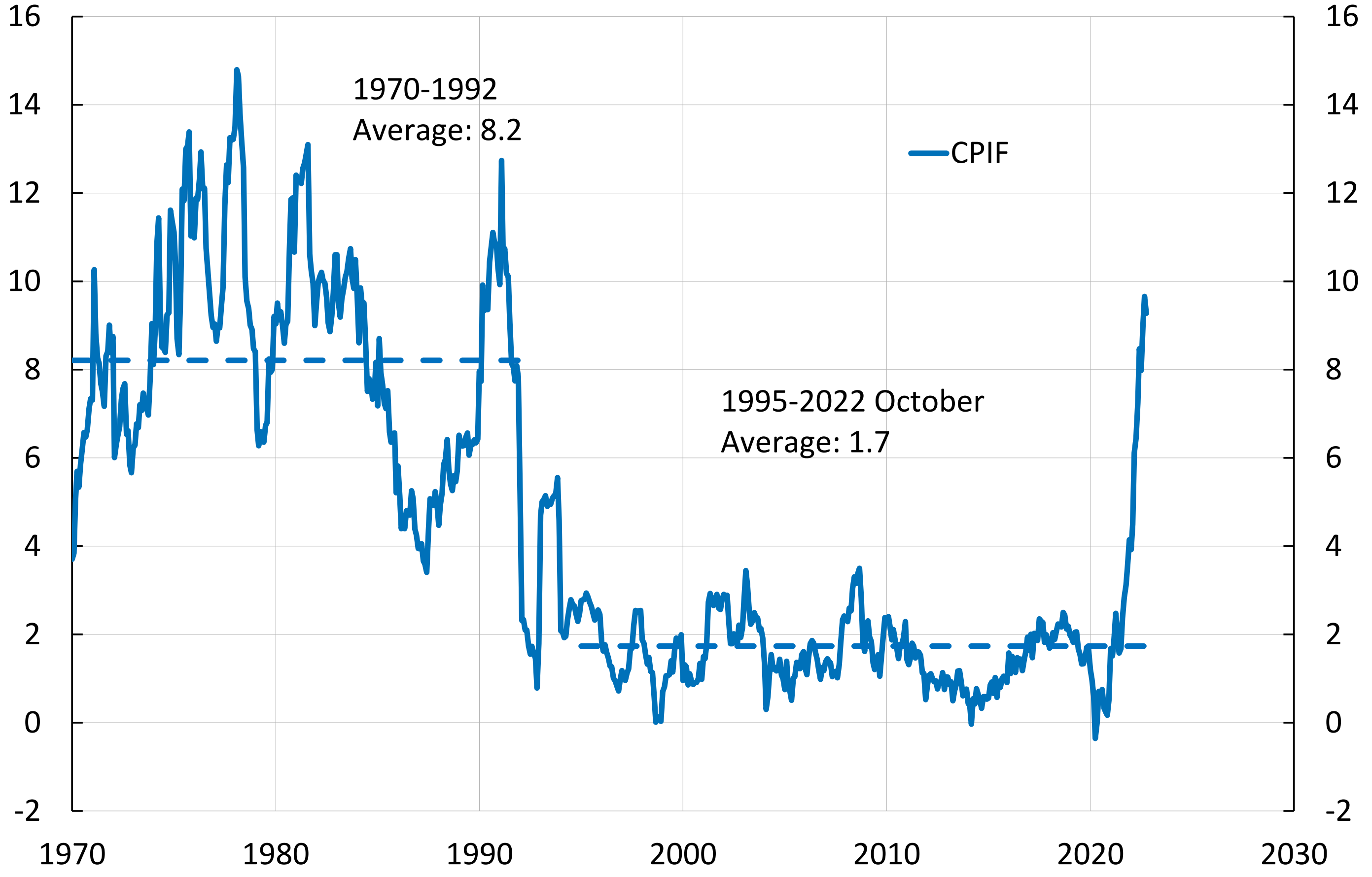
Measures of underlying inflation



Note. Annual percentage change. The range in the figure on the right shows the highest and lowest outcomes among seven different measures of underlying inflation.

Sources: Statistics Sweden and the Riksbank.

Similarities to 1970s



Note. Annual percentage change. Inflation is measured as the CPIF and before 1987 as the CPI excluding interest rates.

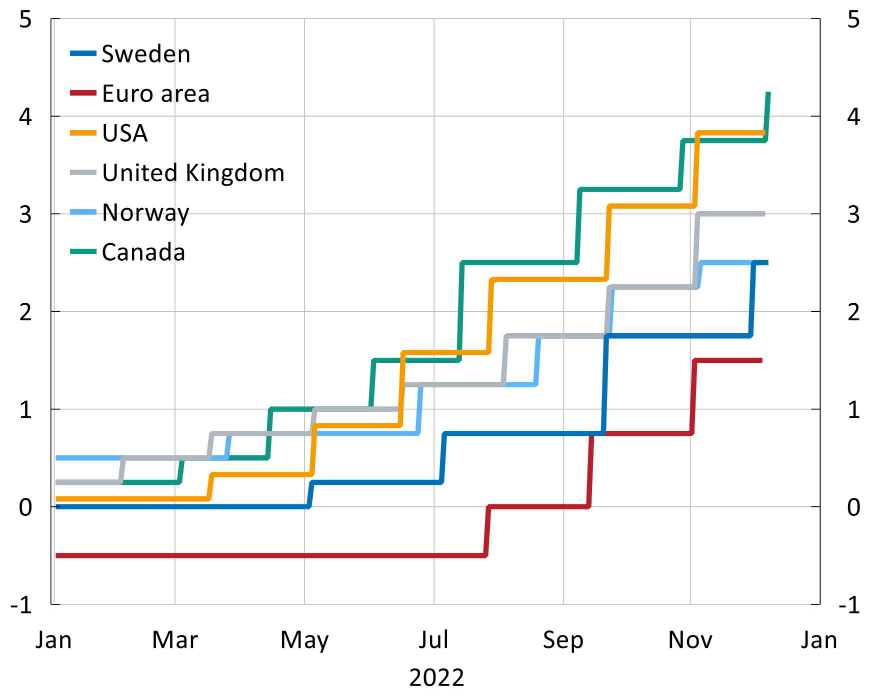
Sources: Statistics Sweden and the Riksbank.

Better designed frameworks provide favourable conditions

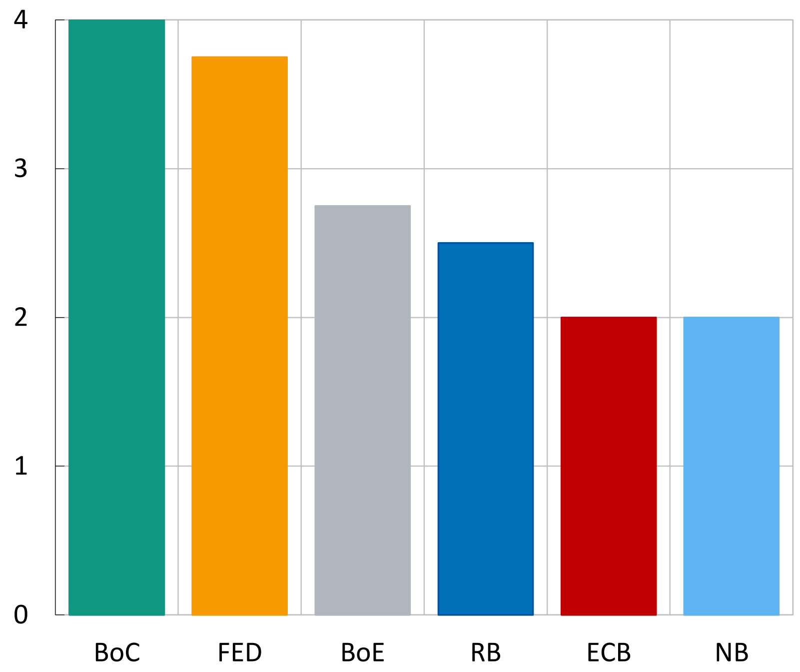
- Inflation target
- Fiscal policy framework
- Better functioning wage formation

Central banks have reacted relatively quickly and in unison

Policy rates



Increases so far this year



Note. Per cent and percentage points.

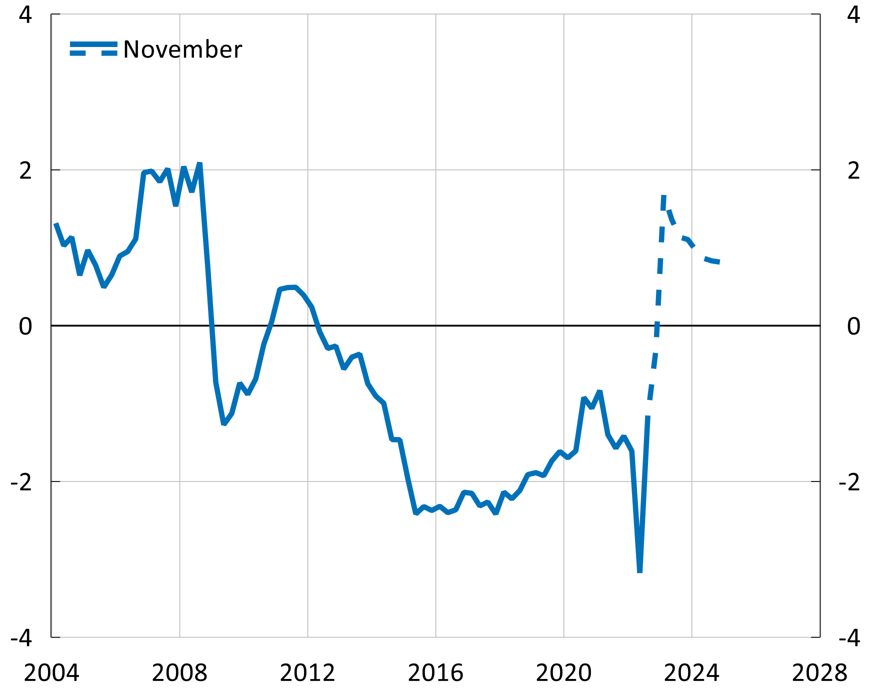
Sources: National central banks.

Back to the target

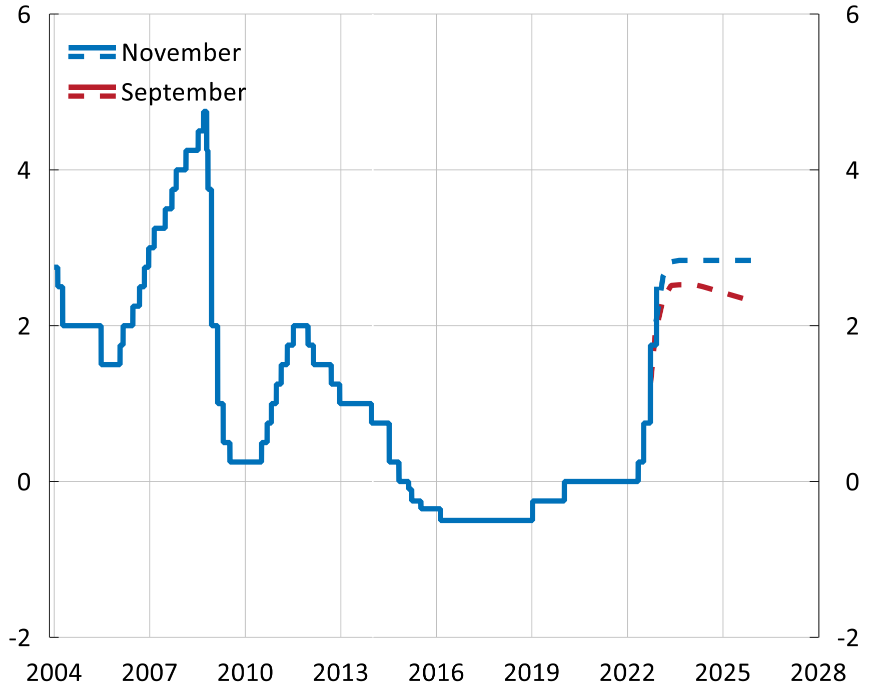
GOOD SCENARIO	BAD SCENARIO
✓ The hikes mean that inflation will start to decline in 2023 ✓ Supply restrictions will fade away ✓ Continuing anchored inflation expectations, wage increases based on inflation target ✓ Fiscal policy targeted	✓ Hikes insufficient ✓ Agents begin to doubt the target ✓ High wage increases, price-wage spiral ✓ Broad fiscal policy stimulation

In a good scenario, the Riksbank does not need to make very large interest rate hikes

Real policy rate



Nominal policy rate

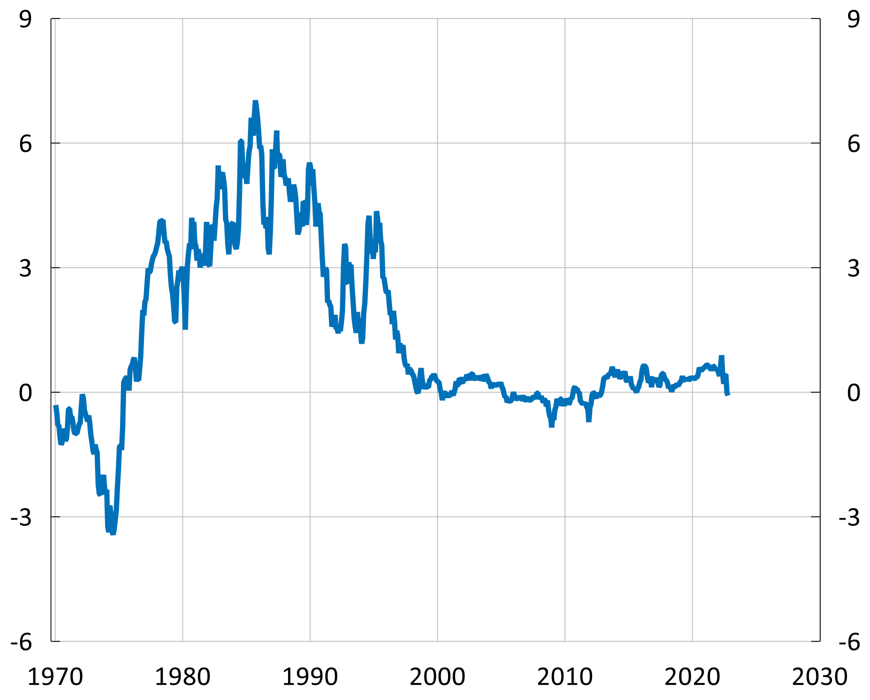


Note. Per cent. The real policy rate is the Riksbank's expected real interest rate, calculated as a quarterly mean value of the Riksbank's policy rate forecast one year ahead minus the inflation forecast (CPIF) for the corresponding period. As the real interest rate is a forward-looking variable, the outcomes are also based on forecasts. The outcomes are calculated on the basis of the most recently published forecasts at that point in time.

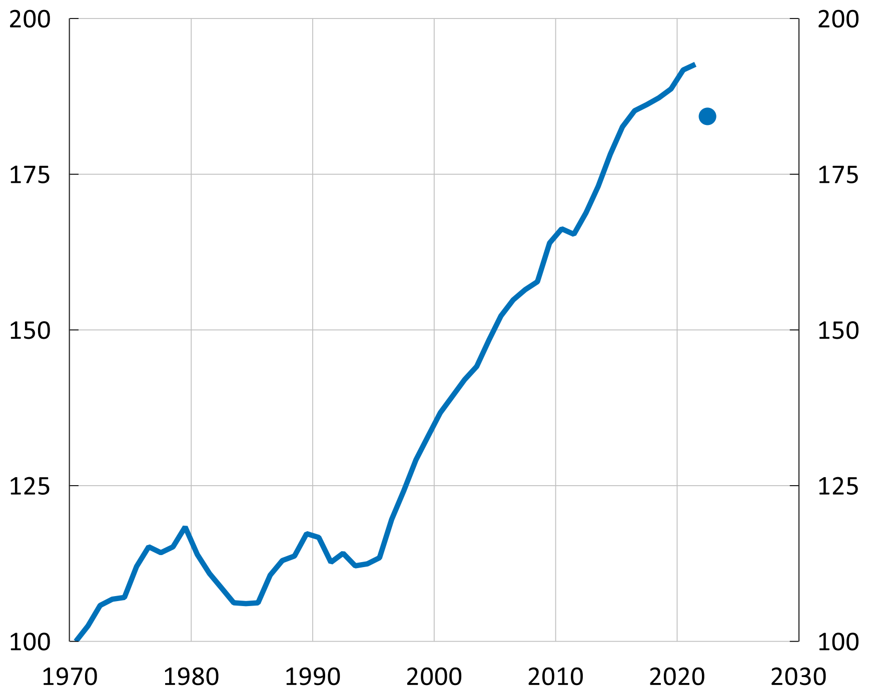
Source: The Riksbank.

Favourable development during the inflation-targeting period

Yield differential against Germany



Real wages



Note. Percentage points and index, 1970 = 100. The interest rate differential against Germany is for 10-year government bonds. Real wages are deflated with CPI and the dot refers to the outcome for Jan-Sep 2022.

Sources: Macrobond, the National Mediation Office, the OECD, Statistics Sweden and the Riksbank.