

Credibility and flexibility going forward

Handelsbanken
13 February 2025

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

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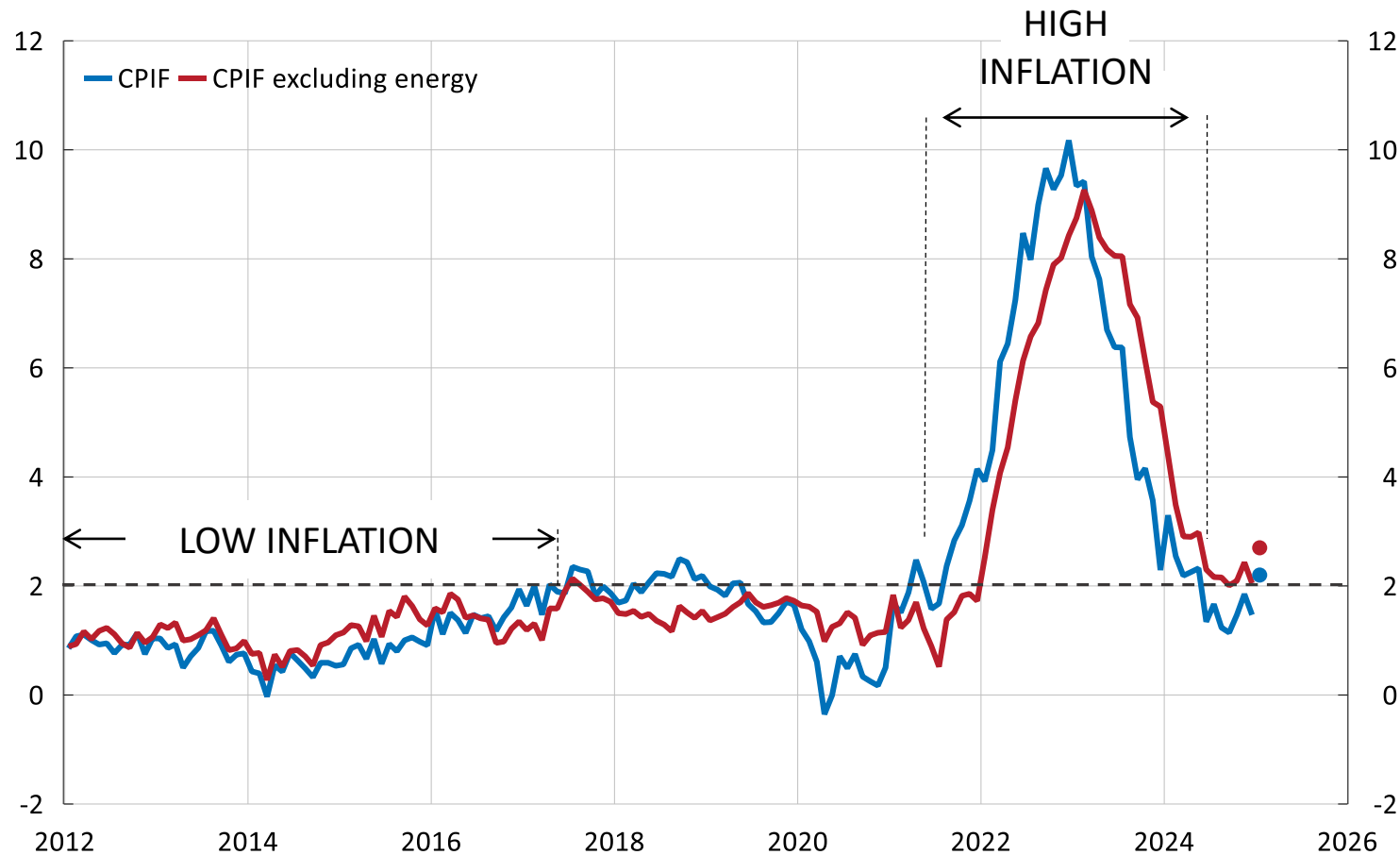
Deputy Governor of the Riksbank

Agenda

- Credibility and flexibility going forward
- Current monetary policy



The inflation target has been tested in two extreme periods – and passed the test



Annual percentage change. Dots refer to preliminary outcomes for January.

Sources: Statistics Sweden and the Riksbank.

More flexibility in monetary policy thanks to investments in credibility?



- **Flexibility in monetary policy** presupposes **confidence in the inflation target**
- The **greater the credibility** the **fewer interest rate changes** are **necessary**
 - Less risk of inflation getting stuck at too low or too high a level
- Possible consequence: Less need to act as forcefully in the event of deviations from the target – this has some **positive side-effects**

Smaller interest rate changes preferable to larger ones – if credibility is not jeopardised



- Impact on the real economy
 - Uncertainty about e.g. investments and housing purchases
 - Volatility in financial markets
 - Exchange rate
-
- But requires certain preconditions – good **interaction between** and **support from different actors**

Conditions for more flexible monetary policy



Debate



Wage formation



Price-setting



Fiscal policy

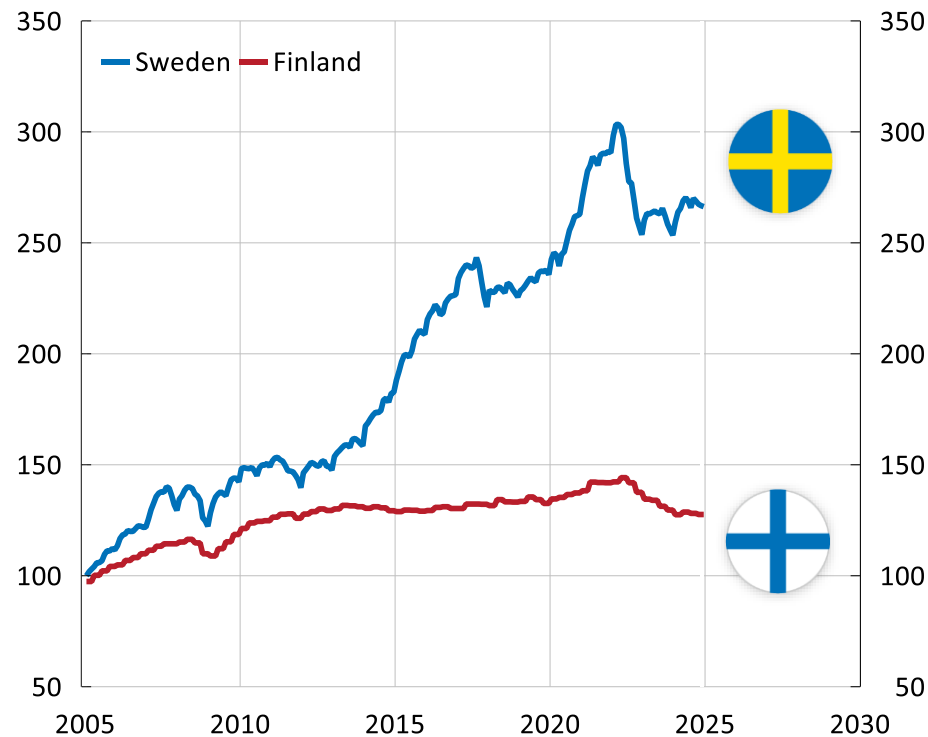
Debate



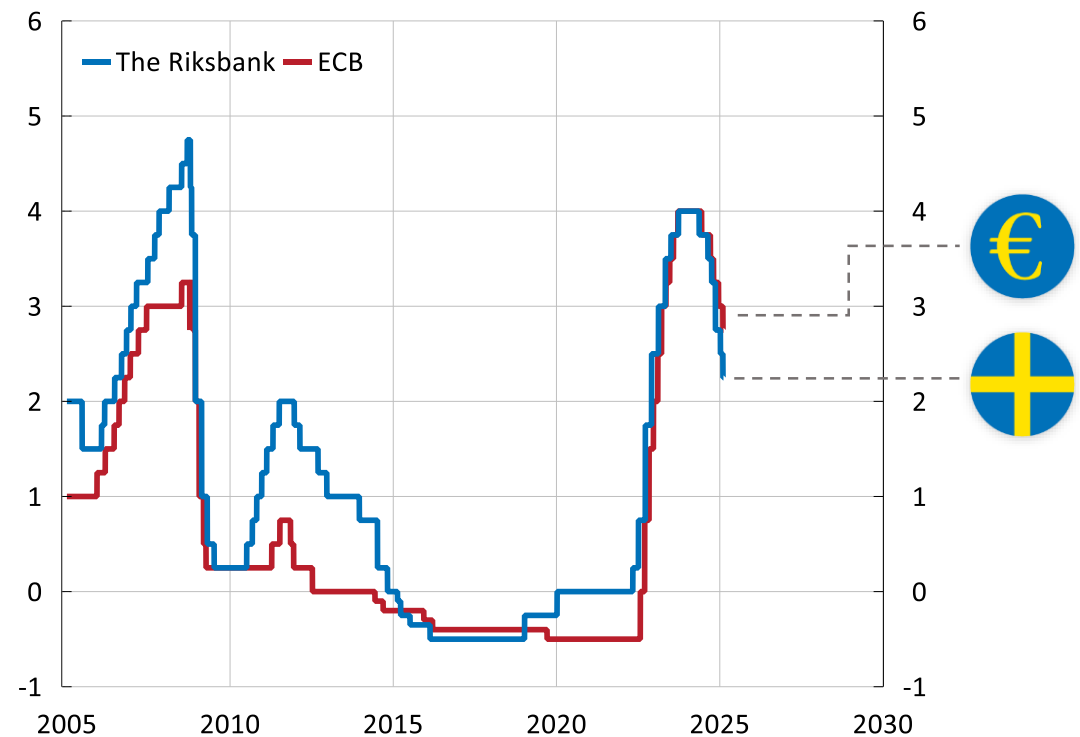
- **Important ongoing debate on monetary policy**
- **But not unusual for the inflation target to be completely ignored**
 - "Interest rates cause/should curb high housing prices and debt"
 - "Monetary policy has turned the krona into a junk currency"
 - But: would have resulted in even lower inflation, perhaps leading to the anchor detaching
 - One omits
 - that the inflation target is statutory and overriding
 - the functioning of the housing market
 - trend decline in neutral interest rate
 - the public assessments of monetary policy

Debate: Lower house prices in Finland with slightly lower policy rate

House prices



Policy rates



Index, 2005 = 100 (left) and per cent (right). The right-hand figure refers to the HOX house price index for Sweden and equity house prices for Finland.

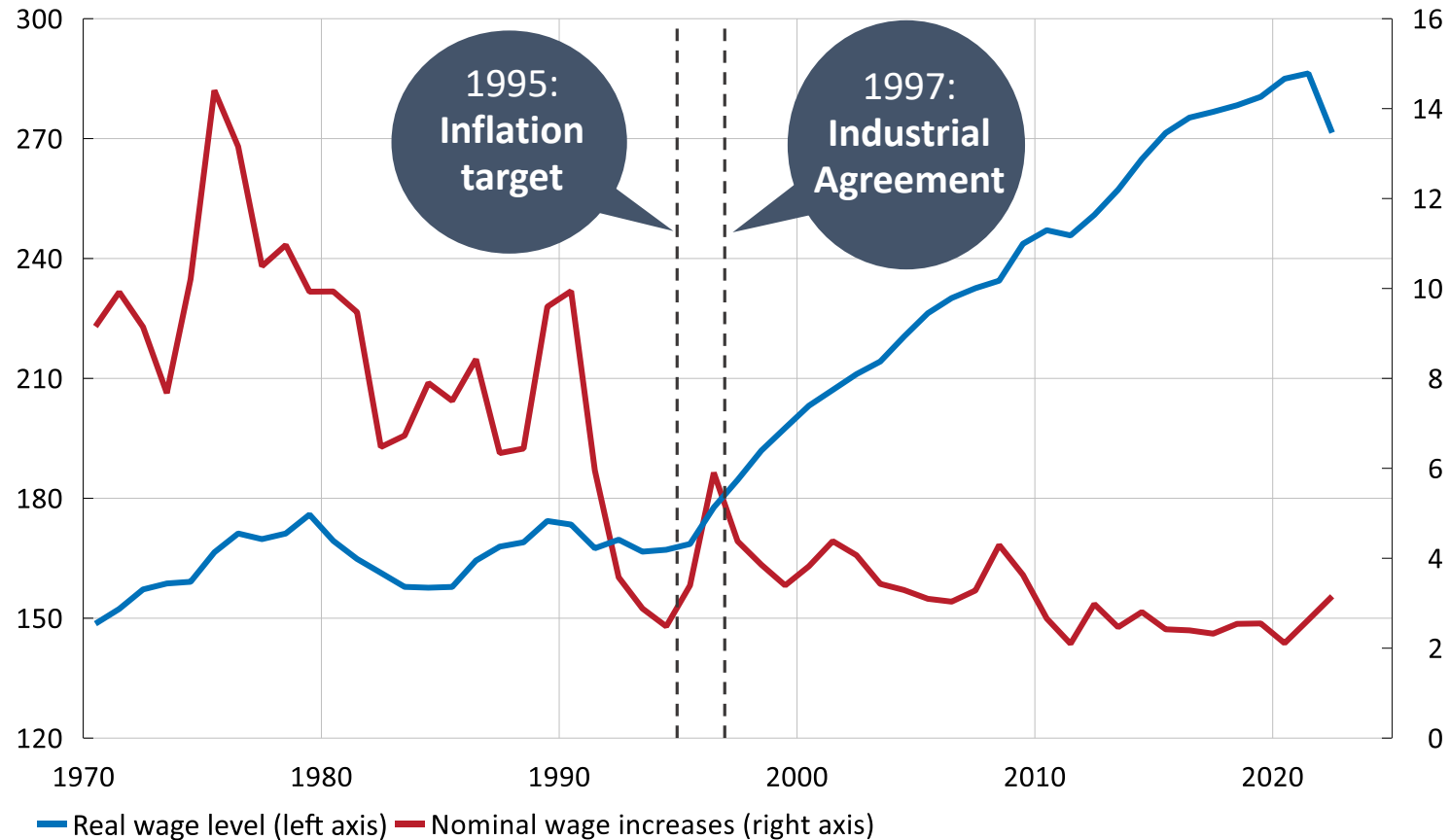
Sources: ECB, Statistics Finland, Valueguard and the Riksbank.

Debate



- Recent years: "**The rise in inflation was due to supply shocks and the interest rate should not have been raised**"
 - Both supply and demand
 - Even supply shocks require interest rate hikes (e.g. the 2023 monetary policy review, or any basic textbook...)
- More **nuanced and constructive debate** on the tasks of and conditions for monetary policy given better consideration

Wage formation: well-functioning for 30 years



Index, 1 January 1960 = 100 (blue line), and annual percentage change (red line). Real wages are based on the CPI.

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

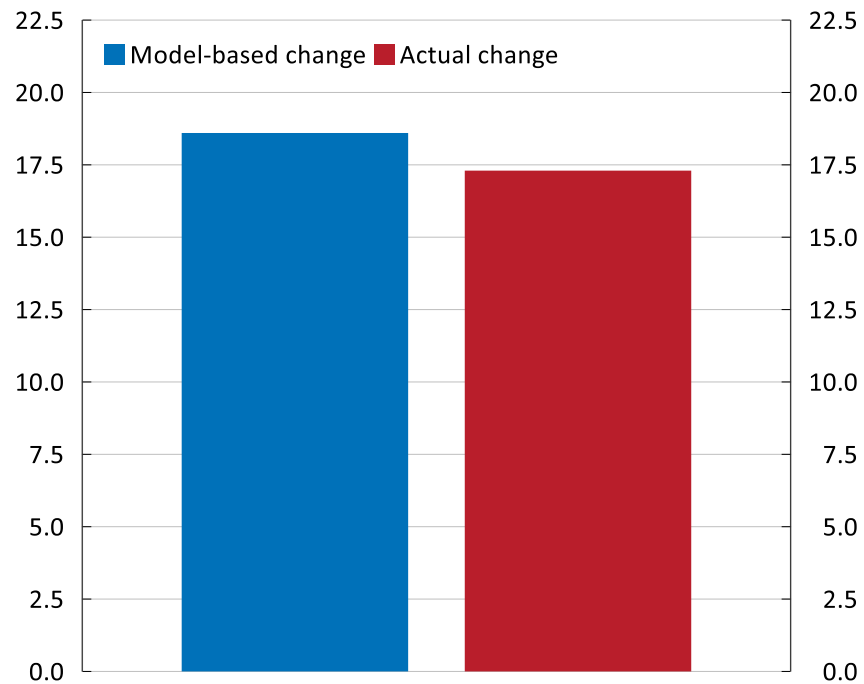
Wage formation



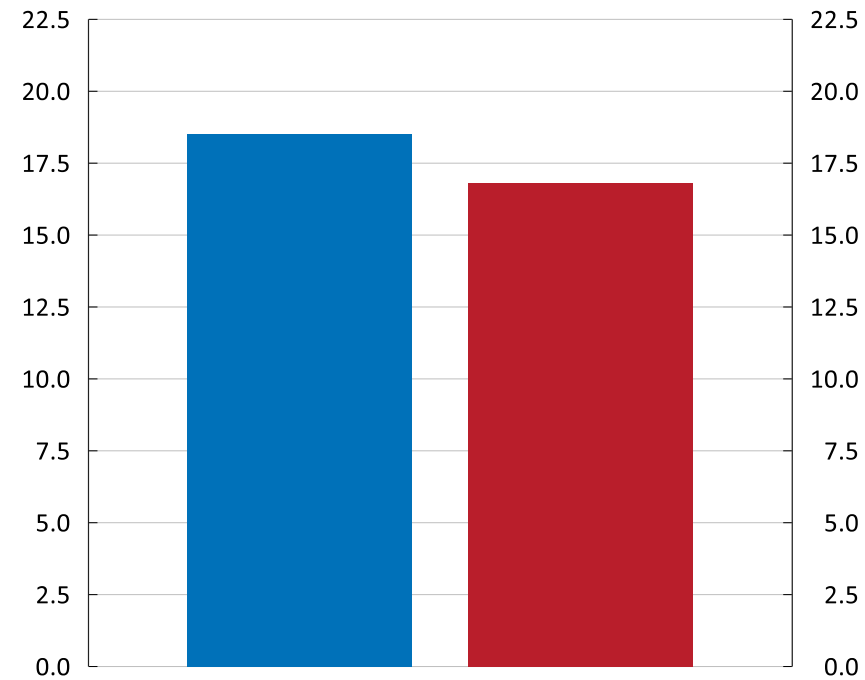
- Recent years: moderate wage increases despite high inflation
- Assumption that **the Riksbank will deliver, BUT** insight that one also **plays a role in the “delivery”**
- Current regime not written in stone
 - Prolonged high inflation affects expectations
 - "Institutional memory" is not eternal

Price-setting: changing behaviour in the face of high inflation

CPIF – increase 2019:2-2023:2



CPIF excluding energy – increase 2019:2-2023:2



The figures show the NIER's model-based calculations of price developments under the assumption of full pass-through of cost increases compared with the actual price developments during the same period. The profit share is kept constant in the modelling.

Sources: Statistics Sweden and the National Institute of Economic Research (NIER).

Price-setting



- Question marks over the role of inflation targeting in price setting – experience in many countries
- At least a discussion on price-setting is desirable
- Firms also benefit from smaller rate rises

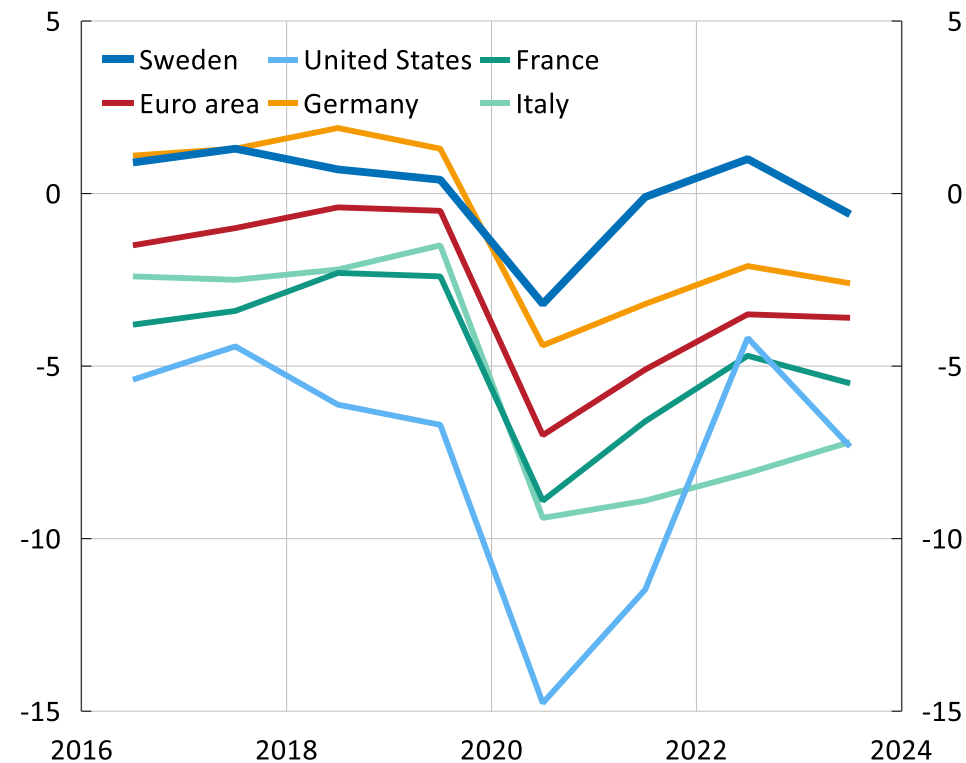
Fiscal policy



- Recent years: fiscal policy has not fuelled the rise in inflation
- But continued discussion on the interaction/policy mix is important
- Difficulties for monetary policy especially if the policy rate is very low
 - "Lower bound"
- Strong public finances still important but no obstacle for fiscal policy to play a slightly larger role

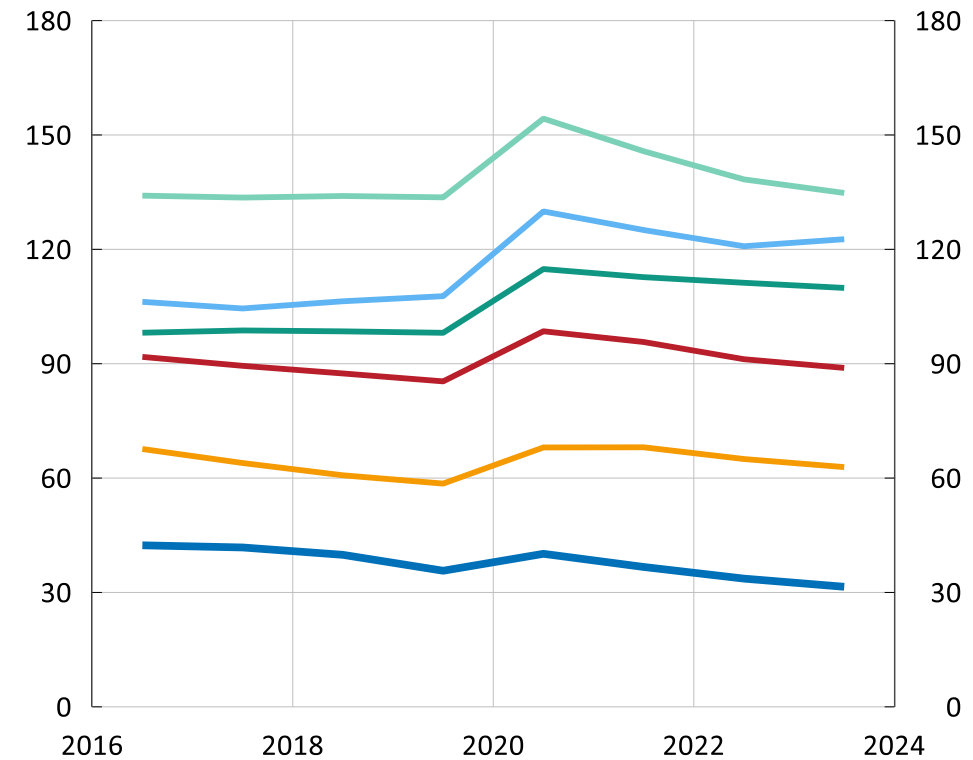
Fiscal policy: room for more flexibility

General government net lending



Per cent of GDP.

Public debt



Sources: Eurostat and the European Commission.

Main messages

- Inflation target has now managed both too low and too high inflation
- Useful test that may have boosted confidence in the target
- Higher confidence may allow more flexible monetary policy – at least at the margin
- Steps in this direction require broad support for the importance of an inflation anchor



Conditions for more flexible monetary policy



Debate

Statutory
inflation target
starting point,
can/should
not fix
"everything"



Wage formation

Worked well
but not a given
that it will do
so for ever



Price-setting

As important as
wage
formation,
more debate
needed



Fiscal policy

Promising
development,
better ongoing
policy mix
desirable

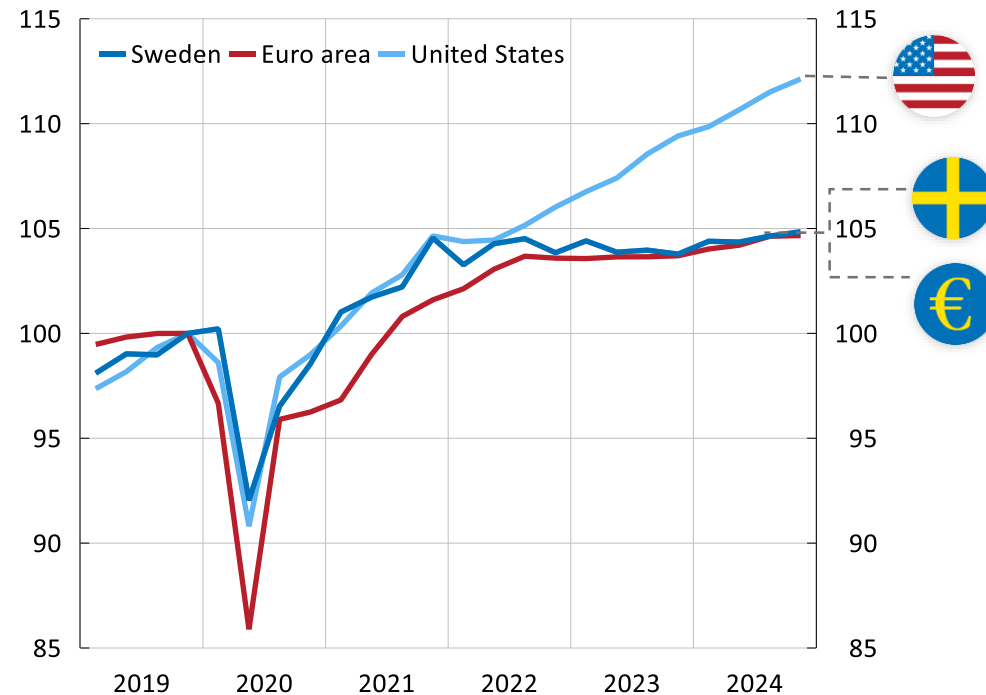
Monetary policy, January 2025

- Policy rate **cut by 0.25** percentage points to 2.25 per cent
- **The forecast** for the policy rate essentially holds
- The policy rate has been cut by 1.75 percentage points since May, but the cuts have **not yet had full impact**



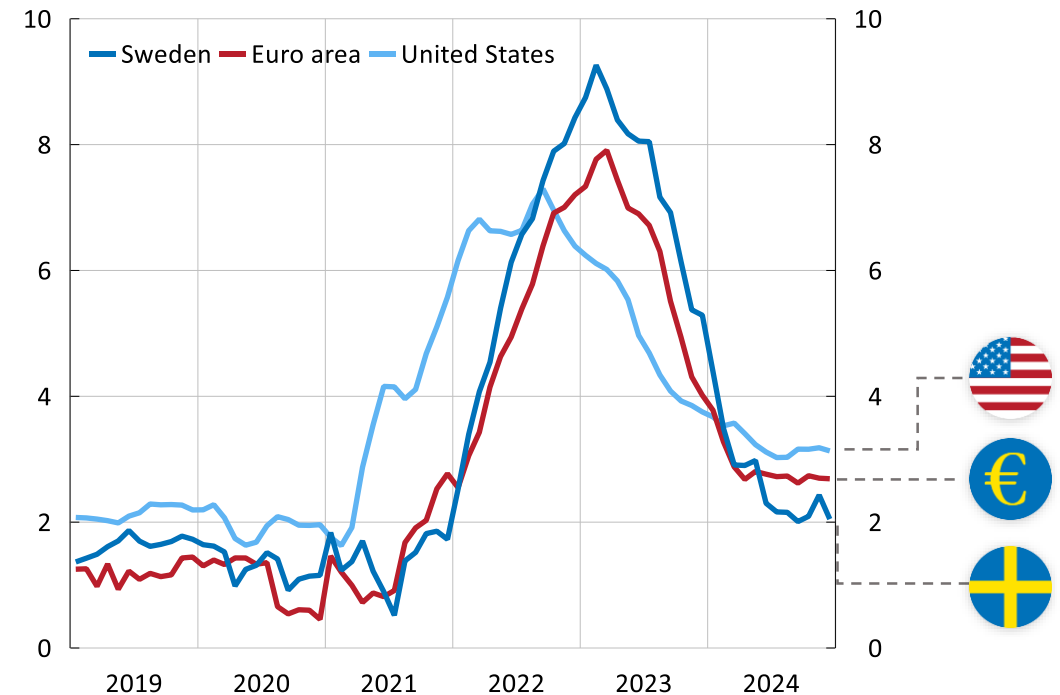
Substantial differences between USA and Europe

Strong GDP growth in USA, weaker in Europe



Index, 2019 Q4 = 100 (left), and annual percentage change (right). Right-hand figure refers to CPIF excluding energy for Sweden, HICP excluding energy for the euro area and CPI excluding energy for the USA.

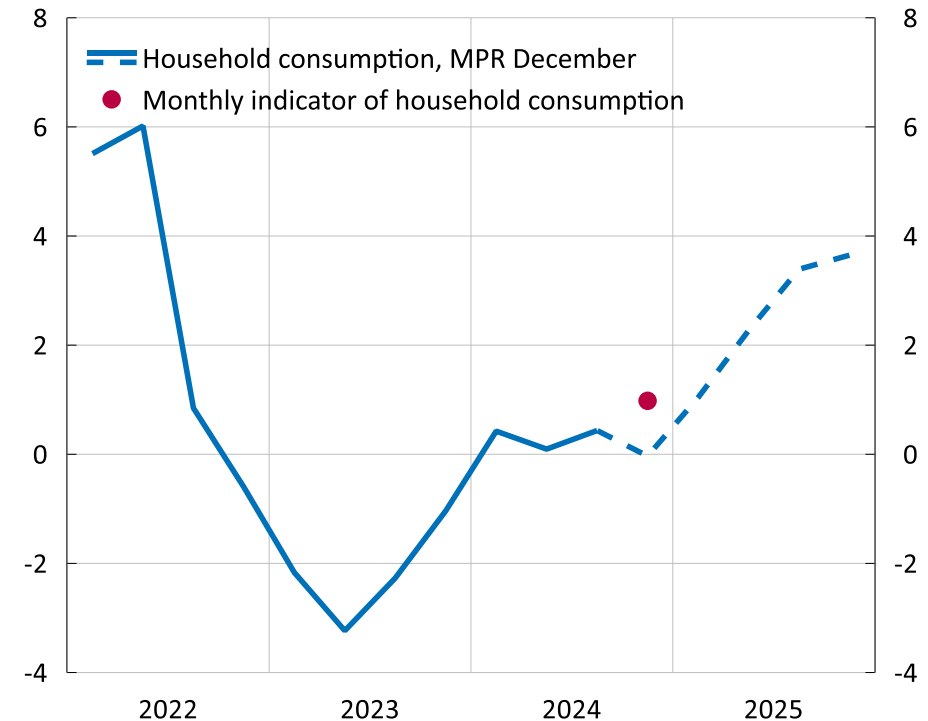
Higher inflation in the USA



Sources: Eurostat, US Bureau of Labor Statistics and Statistics Sweden.

Weak economic activity in Sweden, signs of a rebound

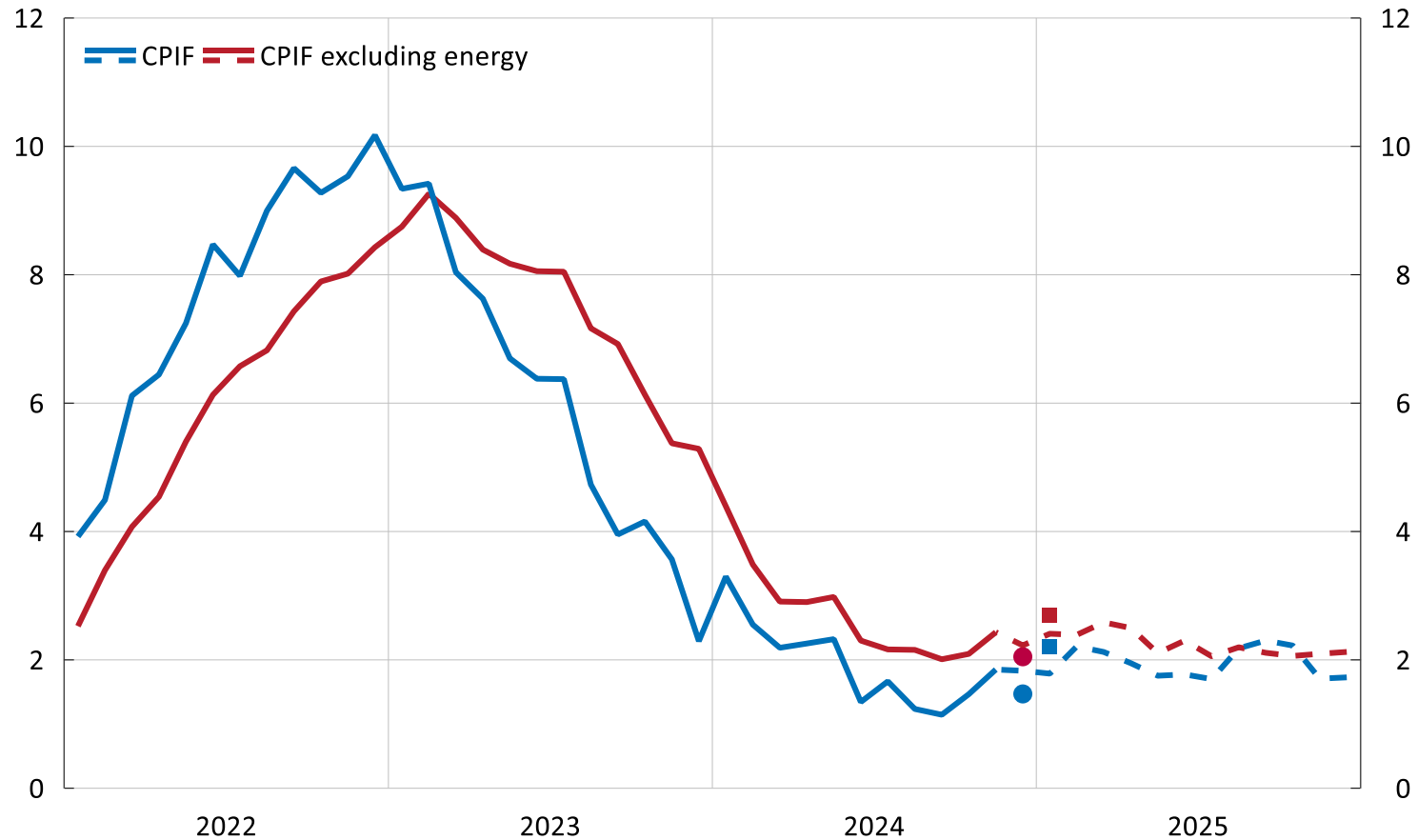
- Good conditions for higher growth
- Signs of stronger consumption
- Continued subdued export order intake
- Indicators support the picture of higher growth this year



Annual percentage change. Solid and dashed blue line refer to outcome and forecast respectively from the Monetary Policy Report (MPR) in December. The dot refers to an average of the outcomes for Statistics Sweden's monthly indicator for household consumption for October-December 2024.

Sources: Statistics Sweden and the Riksbank.

Inflation outlook in line with target...



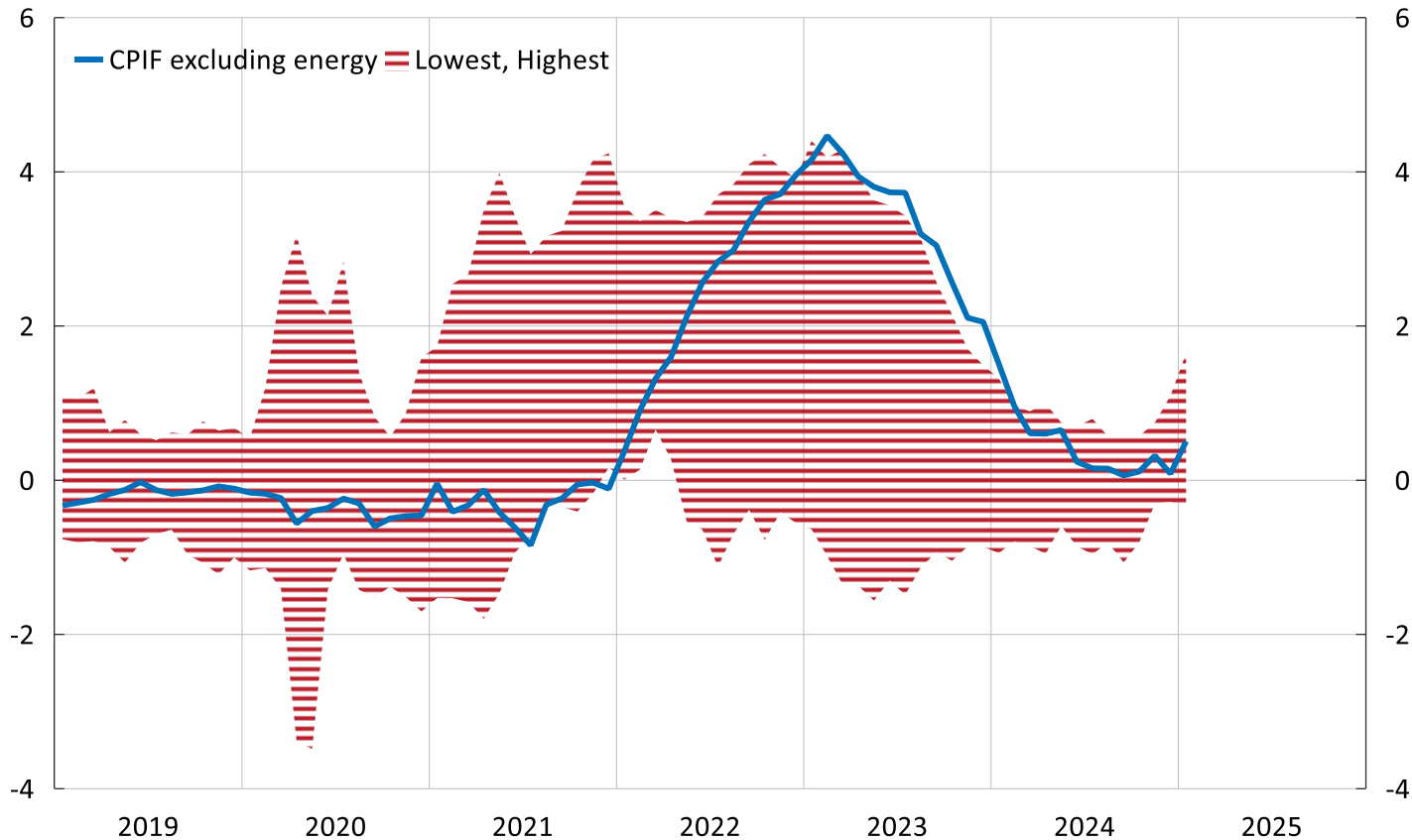
Annual percentage change. Solid and dashed line refer to outcome and forecast respectively at the December monetary policy meeting.

Dots refer to the outcomes for December and squares to the preliminary outcomes for January.

Sources: Statistics Sweden and the Riksbank.

INFLATION
TARGET, CPIF:
2%

...but we must be vigilant



- Household inflation expectations
- Price plans in retail trade, consumer goods industry, and service sectors
- Purchasing managers' index in the service sector and manufacturing industries
- Consumer goods (ITPI, IMPI OCH HMPI)
- CPI excluding energy in the United States and HICP excluding energy in the euro area
- KIX
- The Economist's Commodity Indices Index
- Global Supply Chain Pressure Index

Standardised values. The red band shows the highest and lowest value in the indicators listed on the right. Preliminary outcome for January 2025.

Sources: Economist, Eurostat, Federal Reserve, National Institute of Economic Research, Statistics Sweden, US Bureau of Labor Statistics and the Riksbank.

Outlook for inflation and economic activity is uncertain

The forecast for the policy rate essentially holds

Several factors can affect the outlook for economic activity and inflation:

- Increased trade barriers, economic fragmentation
- The krona exchange rate
- Rebound in the Swedish economy

Monetary policy is forward-looking and guided by a tentative approach

The Riksbank is prepared to act if the outlook changes



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