ISSN 2001-0311

SVERIGES RIKSBANK

Monetary Policy Update April 2014

The global recovery is continuing. The situation in the US economy is gradually improving and prospects also look brighter in the euro area. In Sweden, GDP growth was higher than expected in the fourth quarter of last year. The high growth was partly due to temporary factors, but the broad upturn in demand implies that an economic upturn has begun. The prospects for the Swedish economy also remain bright. Although the labour market has shown somewhat weaker development than expected recently, the Riksbank still assesses that there will be a clear improvement in the situation during the second half of this year.

Inflation is low and is expected to remain low for the rest of the year. Since the Monetary Policy Report was published in February, inflation has been somewhat lower than expected and the forecast is revised down, for the coming months in particular. Price increases have been low over a long period of time in relation to developments in companies' costs. As the demand situation improves, however, companies are expected to increasingly pass on their cost increases to consumers. CPIF inflation is therefore expected to begin to rise towards the end of the year and to be close to 2 per cent during the latter part of 2015.

Economic activity is now strengthening clearly and household indebtedness as a share of disposable income is expected to increase more than was previously forecast. Although inflation has been somewhat lower than expected, only a minor revision has been made to the inflation forecast. Given this, the repo rate is held unchanged at its current low level of 0.75 per cent. It is judged appropriate to begin gradually raising the repo rate in one year's time, when inflation has picked up. However, it is uncertain how quickly inflation will rise, particularly given that inflation has been weaker than expected for some time. The forecast for the repo rate has therefore been adjusted down somewhat and reflects the greater probability of a repo-rate cut in the near term compared with the assessment made in February.

Figure 1. Repo rate with uncertainty bands
Per cent

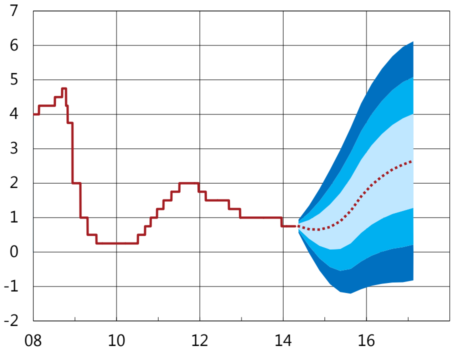


Figure 2. GDP with uncertainty bands
Annual percentage change, seasonally-adjusted data

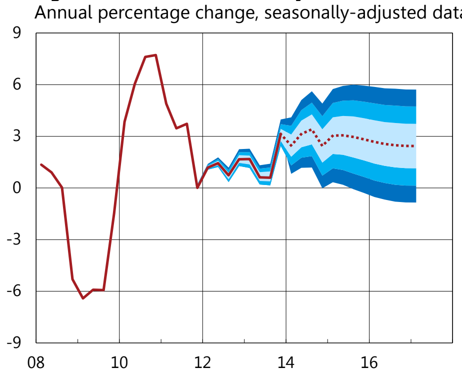


Figure 3. CPI with uncertainty bands
Annual percentage change

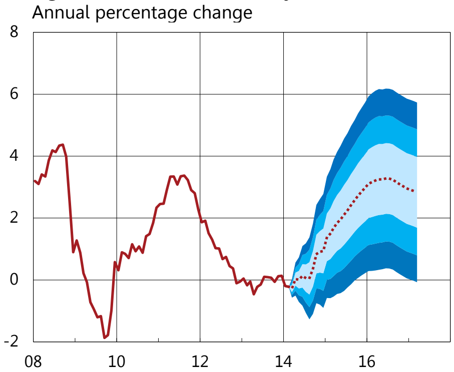
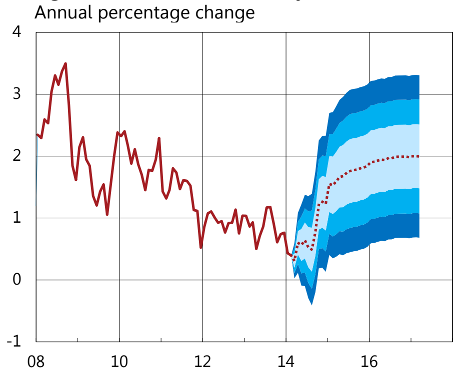


Figure 4. CPIF with uncertainty bands
Annual percentage change



90 %   75 %   50 %

Note. The uncertainty bands in the figures are based on historical forecast errors, see the article "Calculation method for uncertainty bands" in MPR 2007:1. The uncertainty bands do not take into account the fact that there may be a lower bound for the repo rate. Outcome data for the repo rate are daily rates and forecasts are quarterly averages.
Sources: Statistics Sweden and the Riksbank

The Executive Board decided to adopt the Monetary Policy Update at its meeting on 8 April 2014. The interest rate decision is presented in a press release at 9.30 a.m. on the day following the monetary policy meeting.

■ The economic outlook and inflation prospects

The economic outlook and inflation prospects reported in this Monetary Policy Update are based on the assessments made in the Monetary Policy Report in February and the forecast updates made since then. The forecasts are based on the decision to hold the repo rate at 0.75 per cent and to adjust the repo-rate path downwards. The downward adjustment reflects the fact that it is more likely that the repo rate will be cut than that it will be raised if it is changed in the near term.

■ Recovery continuing abroad

Growth abroad will continue to strengthen during the forecast period. This development is supported by, for instance, the central banks' expansionary monetary policy with prospects of continued low policy rates, which contributes to creating expansionary financial conditions abroad. Moreover, debts in the household and corporate sectors have been reduced in many areas. This provides better conditions for both increased domestic demand and stronger trade in several countries in the coming years. GDP growth in the countries that are most important to the Swedish economy is expected to rise from just over 2 per cent in 2014 to almost 3 per cent in 2016, when measured in terms of KIX-weighted GDP.

Inflation abroad is low and as in the assessment made in February, cost pressures are expected to remain relatively moderate in the near term. During the forecast period, inflation is expected to rise gradually as demand picks up and companies have greater opportunity to raise their prices. The KIX-weighted inflation rate is expected to be just over 2 per cent at the end of the forecast period. The assessment assumes that energy prices will continue to develop in a stable manner despite the increased political unease regarding events in Ukraine. Monetary policy abroad is expected to remain expansionary.

■ Low market rates and stable krona

The expansionary monetary policy conducted by central banks has helped keep down market rates in large parts of the world. While there is considerable uncertainty over developments in Ukraine, they have so far had limited spread to the financial markets and are not expected to hamper the recovery in the global economy. In Sweden, the continuing low interest rates have entailed favourable financing conditions for the government and for banks. This in turn has generated low lending rates to Swedish households and companies, which stimulates the Swedish economy.

In trade-weighted terms, the krona has been relatively stable for more than a year, and in recent months has developed in line with the assessment in the February Monetary Policy Report. The krona is expected to strengthen somewhat during the forecast period, both in nominal and real terms. The long-run forecast for the nominal exchange rate is based on an assessment of the development of the real exchange rate. The Riksbank's assessment is that the real exchange rate is currently close to its long-run level.

■ Positive signs in the euro area

Economic activity is slowly continuing to improve in the euro area. GDP growth has been positive for the past three quarters and confidence indicators are pointing to continued growth. Although the recovery has until now been held back by the continued consolidation need regarding both public and private debt, there are signs that other dampening factors will decline in significance in the coming period. Credit terms have become less strict and interest rates offered to households and companies have fallen. Unemployment is at a high level, but has not continued to rise in recent months. Moreover, fiscal policy is not expected to be as tight in the coming period. All in all, this is expected to contribute to some increase in domestic demand. Further, global demand is expected to rise. The forecast is for GDP growth in the euro area to increase gradually to almost 2 per cent a year in 2015-2016.

The relatively slow recovery means that it will take time for inflation to rise. The adjustment to lower costs in the countries with sovereign debt problems will also contribute to holding back inflation in the euro area as a whole. In 2016, inflation is expected to be 1.7 per cent. The weak resource utilisation and low inflation justify monetary policy remaining very expansionary during the forecast period.

■ Continued recovery in the United States following temporary setback

The situation in the US economy is continuing to improve. GDP growth was relatively high during the second half of the year. However, an unusually cold winter is thought to have contributed to temporarily dampening activity, which has meant that growth in the short term has been revised down somewhat, compared with the assessment in the February Monetary Policy Report. In the coming period, growth will benefit from high profits and a relatively high level of confidence among companies, which will create good conditions for a rise in employment and investment. At the same time, households are expected to reduce their saving and increase their consumption. The recovery is also supported by continuing very expansionary monetary policy and by the expectation of less tight fiscal policy. This is expected to contribute positively to growth in domestic demand.

All in all, GDP growth in the United States is expected to increase to just over 3 per cent a year in 2014-2015, and then fall somewhat when the economy approaches full resource utilisation. Inflation, which has been relatively low over the past two years, is expected to rise gradually during the forecast period as the spare capacity in the economy is used.

■ Brighter prospects on other important export markets

Economic activity in the United Kingdom has increased markedly and growth is expected to remain high during the forecast period. The driving factors behind this development include higher demand from abroad, continuing expansionary monetary policy and more generous credit terms for households and companies. GDP growth is expected to be just over 2.5 per cent a year in 2014-2016 and inflation is expected to be in line with the target of 2 per cent.

The recovery in the Danish economy is continuing, following the domestic property and banking crisis. Households have gradually reduced their debt and as the situation on the labour market brightens, the conditions are right for some increase in consumption. This, together with a slight improvement in demand from the euro area in particular, will contribute to GDP growth rising to 2 per cent towards the end of the forecast period. CPI inflation has fallen over the past year, but is expected to rise towards 2 per cent.

In Norway, growth prospects weakened last year, partly because of a slowdown in the oil sector and the housing market. During the coming period, the more positive developments abroad will contribute to mainland GDP growth rising from around 2 per cent to almost 3 per cent at the end of the forecast period. Inflation is also expected to rise and gradually approach Norges Bank's inflation target of 2.5 per cent.

In China, investment has been the most important driving force behind growth. A changeover is currently taking place in the economy, whereby consumption is becoming increasingly important. The rapid credit growth in recent years, combined with underlying weaknesses in the financial system gives cause for concern. The government has decided on reforms that will contribute to making the Chinese economy more market-oriented. All in all, GDP growth is expected to be around 7 per cent a year during the remainder of the forecast period, while inflation is expected to be around 3 per cent.

In Japan, growth has benefited from an expansionary economic policy. Demand and inflation are greatly affected in the short term by VAT increases to be implemented this year and next year. GDP growth is expected to decline to just over 1 per cent a year in 2015-2016. Consumer prices, which began to rise in 2013, will continue to rise this year. The upturn is partly explained by the weak yen, which has contributed to higher import prices, and partly by the fact that companies were able to raise their goods prices when demand increased prior to the imminent VAT increases. Towards the end of the forecast period, CPI inflation is expected to be close to the Japanese central bank's inflation target of 2 per cent.

■ Economic upturn has begun in Sweden

Growth in Sweden was higher than expected in the fourth quarter of last year. The rapid increase in GDP was the result of both a broad upturn in demand and some temporary factors, such as high investment in stocks and high government sector consumption. A short-term slowdown in growth is expected in the first quarter of this year, but after that GPD is expected to increase again at a faster pace than normal. The prospects for the Swedish economy are relatively bright and depend on both increased demand from abroad and an improved domestic demand situation, given the expansionary economic policy, for instance.

Higher demand abroad has led to an acceleration in export orders. Exports have also begun to increase and are expected to grow at a stronger pace in the coming period. The conditions are right for continued good growth in consumption. The household confidence indicator, which summarises households' views of their own finances and the Swedish economy, is now in line with its historical average. During 2014-2016 households' disposable incomes are expected to increase in line with the historical average, although rising interest rates and tighter fiscal policy will slow down growth in incomes in 2015. Household consumption is expected to increase faster than incomes during 2015 and 2016, which means that households will reduce their saving in these years. This is normal in a recovery phase.

Weak demand and uncertain economic prospects contributed to a fall in investment in 2013. This is despite a rapid rise in growth in housing investment. Growth in investment is expected to increase gradually this year and to be high in 2015. This is mainly because companies' investment needs will increase as demand increases. Growth in housing investment is expected to continue at a rapid pace for most of 2014. However, towards the end of the year, growth will slow down somewhat and residential construction will level off at a relatively high level in relation to construction over the past 20 years.

As the GDP outcome for the fourth quarter of last year was stronger than expected, the growth forecast for 2014 has been revised up in relation to the forecast made in February. One consequence of the strong GDP outcome was that productivity was surprisingly high at the end of last year. The higher level is assessed to be temporary to some extent. Next year, GDP is expected to increase somewhat more slowly than was assessed in February, as a result of the downward revision in the forecasts for Swedish export market growth and households' disposable incomes. GDP is expected to increase by 2.7 per cent in 2014, 3.2 per cent in 2015 and 2.8 per cent in 2016.

- **Housing prices and debt rising**

Over the past few months, housing prices have continued to increase at a relatively rapid rate. This is thought to be due to a low supply of housing in some regions where demand is increasing rapidly. It is also due to low interest rates and to households being relatively optimistic about economic developments. Housing prices are expected to continue to rise during the forecast period, which will contribute to an increase in household wealth. However, the strong development in prices will also affect household debt in the coming years. Growth in debt is expected to be somewhat higher than growth in incomes, and household debt as a percentage of disposable incomes is thus expected to increase and be around 180 per cent at the end of the forecast period. Compared with the assessment in February, the forecast for the debt ratio has been revised up slightly, mainly because household incomes are expected to increase somewhat more slowly. This is partly because of a new assessment of households' capital incomes.

- **Public finances strengthen when economic activity improves**

The Riksbank's forecast for fiscal policy is based on measures announced earlier and an assessment based on how fiscal policy is usually adjusted to the state of the economy and the policy objectives set by the fiscal-policy framework. The forecasts for 2015 and 2016 assume that the fiscal policy measures implemented have been financed.

Net lending amounted to -1.3 per cent of GDP in 2013 and is expected to be -1.9 per cent of GDP in 2014. As economic activity improves, general government net lending is expected to strengthen in 2015 and 2016 but nevertheless show a deficit of -0.1 per cent of GDP in 2016. Compared with the February Monetary Policy Report, the forecast for net lending has been revised down somewhat during the forecast period, primarily due to lower income from VAT and excise duties and to higher public consumption.

- **Recovery in the labour market slower than expected**

The GDP outcome for the fourth quarter of 2013 meant that growth was higher than expected last year. However, at the start of 2014 the labour market has been somewhat weaker than was forecast in February, with slower growth in employment and somewhat higher unemployment. Although the labour market has shown somewhat weaker development than expected recently, the Riksbank still assesses that a clear improvement will take place during the second half of the year. Indicators point to companies having a more optimistic outlook on the future. The number of redundancies has continued to decline and employment plans in the business sector are higher than normal, according to the National Institute of Economic Research's Business Tendency Survey.

According to the National Accounts for the fourth quarter, the number of hours worked was weaker than the Riksbank had forecast in February, which together with the strong GDP outcome gave a higher growth in productivity and lower average working hours than expected. As economic activity strengthens, the number of hours worked and employment are expected to grow faster and average working hours to rise. Towards the end of the forecast period the employment rate, that is, the number of employed as a percentage of the population aged 15-74, is expected to amount to just over 66 per cent, and unemployment is expected to have fallen to around 6.5 per cent. This is in line with the assessment in the February Monetary Policy Report.

■ Resource utilisation lower than normal but will rise

In terms of GDP growth, economic activity has strengthened surprisingly quickly recently, which indicates that resource utilisation is currently higher. On the other hand, labour market indicators of resource utilisation point to developments being somewhat weaker than expected. The number of hours worked and employment have been lower and unemployment has been somewhat higher, compared with the Monetary Policy Report published in February. The Riksbank's overall assessment is that resource utilisation is still lower than normal. According to both the National Institute of Economic Research's Business Tendency Survey and Statistics Sweden, capacity utilisation in the manufacturing industry has begun to rise, but is still below the historical average and the percentage of companies stating a shortage of labour remains low.

The low interest rate, together with higher global and domestic demand, contributes to higher employment and more hours worked. As in the assessment made in February, resource utilisation is expected to be roughly normal during the latter part of the forecast period.

■ Rate of wage increase rising gradually

The agreed wage increases land on average at 2.2 per cent a year in 2014 and 2015, according to the National Mediation Office's compilation. The next large-scale wage bargaining rounds will be in 2016, when wage agreements covering around 2.7 million employees, are expected to expire. There is a trend towards an increase in so-called figureless agreements, and in 2015 almost 800,000 employees will be covered by one of these wage agreements. This development comprises an uncertainty factor in the forecasts of future wages.

During the forecast period, the rate of wage increase in the economy as a whole is expected to rise gradually as economic activity and the labour market situation improve. The rate of wage increase in the economy as a whole, according to short-term wage statistics, is expected to rise from 2.8 per cent this year to 3.4 per cent in 2016, which is largely the same assessment as in February.

Productivity was stronger than expected in the fourth quarter of last year. However, there can be substantial variations between quarters and at present the interpretation is that some of the strong development was temporary. However, measured as an annual percentage change, productivity growth will be much stronger this year than in recent years. During the remainder of the forecast period, productivity is expected to develop more slowly, which will contribute to the annual rate of growth in unit labour costs rising during the forecast period.

■ Inflation will remain low over the coming year

Inflation has been slightly lower than the assessment in February. CPI inflation was -0.2 per cent and CPIF inflation 0.4 per cent in both January and February. One explanation for the inflation outcomes being lower than forecast is that energy prices were lower than expected. CPIF inflation excluding energy was 0.8 per cent in February, which was in line with the earlier assessment. The long-run fall in goods prices slowed down at the beginning of the year, when expressed as an annual percentage change. Price increases on services have at the same time remained low.

The low inflation has not been fully explained by normal correlations between developments in companies' prices and costs for some time now.[1] One important explanation for the low inflation rate is thus assumed to be that companies have found it difficult to pass on their cost increases to consumers. This could in turn be because demand has been weaker than normal and because there has been so much uncertainty about the situation abroad. Since the Monetary Policy Report was published in February, the National Accounts for the fourth quarter of 2013 have been published. According to them, unit labour costs showed an unexpected fall at the end of last year, as productivity was increasing rapidly. Even given this new information, prices are expected to increase slowly in relation to the trend in costs.

An expansionary monetary policy contributes to resource utilisation rising during the forecast period, which will lead to higher wage increases and greater scope for companies to raise their prices. In addition, international goods prices are expected to rise as global economic activity improves and the krona is expected to be relatively stable. All in all, import prices measured in Swedish krona are therefore expected to increase during the forecast period. The weaker development in unit labour costs towards the end of last year is assessed as partly temporary and thus has not had any major effect on the inflation forecast. However, there is great uncertainty over developments. If GDP growth continues to be driven by stronger productivity growth, a strengthening of economic activity could mean lower cost pressures than in the current assessment.[2]

Measured as an annual percentage change, inflation will be very low this year. The forecast for CPIF inflation excluding energy has been revised down marginally for the coming months, compared with the assessment in February, as a result of a continued weak growth in service prices and of the somewhat lower cost pressures. In line with the earlier assessment, inflation using this measure will increase towards the end of 2014 and at the beginning of 2015, when the recent low outcomes no longer affect the annual rate of increase. CPIF inflation is also expected to begin to rise towards the end of the year and to be close to 2 per cent during the latter part of 2015. Compared with the assessment in February, the forecast for CPIF inflation has been revised down somewhat up to the middle of 2016 as a result of the lower expected rate of increase in energy prices.

Households' mortgage interest expenditure will rise when the increases in the repo rate begin. This will in turn lead to CPI inflation increasing faster than CPIF inflation. The rate of increase in the CPI is expected to be highest at the end of 2016 and then fall slowly towards the target. During periods with large interest rate adjustments, measures of inflation that do not include the direct effects of interest rate adjustments, such as the CPIF, provide a better picture of underlying inflationary pressures. In the longer run, when the repo rate has stabilised, CPI inflation and CPIF inflation will coincide, however.

[1] See the article "Perspectives on the low rate of inflation" in Monetary Policy Report, February 2014.
[2] See the scenario "The development of costs and inflation" in Chapter 2, Monetary Policy Report, February 2014.

■ Monetary policy considerations

The Executive Board of the Riksbank has decided to hold the repo rate unchanged at 0.75 per cent, and it is expected to remain at this low level for around one year. After this, the repo rate will be raised gradually and will be around 2.7 per cent at the beginning of 2017. Compared with the Monetary Policy Report in February the repo-rate path has been adjusted down somewhat, which reflects the probability of a repo-rate cut in the near term being slightly greater now than before.

■ Economic activity strengthening, but inflation still low

Economic developments abroad are continuing to improve, well in line with the Riksbank's assessment in the February Monetary Policy Report. But at the same time as some causes for concern have disappeared, some new ones have arisen. One of these is the uncertainty over developments in Ukraine. At present, however, the contagion effects are expected to be limited and not to prevent a recovery in the global economy.

GDP growth was unexpectedly high in Sweden in the fourth quarter of last year. The high growth was partly due to temporary factors, but the broad upturn in demand implies that an economic upturn has begun. The prospects for the Swedish economy also remain bright. Demand from abroad is rising and fiscal and monetary policy are providing stimulus. At the same time, households' debt as a share of their income is expected to rise somewhat more in this forecast than was expected in February. Although the labour market has shown somewhat weaker development than expected recently, the Riksbank still assesses that a clear improvement will take place during the second half of this year.

Inflation has been somewhat lower than expected since the Monetary Policy Report in February and the forecast has been revised down for the coming months in particular. After that, CPIF inflation excluding energy will rise, in line with the forecast in February, while lower energy prices mean that the CPIF forecast has been revised down somewhat in the longer run, too. The revisions are minor, however, particularly during the latter part of the forecast period. Price increases have been low over a long period of time in relation to developments in companies' costs. As the demand situation improves, however, companies are expected to increasingly pass on their cost increases to consumers. CPIF inflation is therefore expected to begin to rise towards the end of the year and to be close to 2 per cent during the latter part of 2015.

Compared with the Monetary Policy Report in February, the forecast for GDP has been revised up, developments in the labour market are expected to be somewhat slower in the short run and CPIF inflation to be somewhat lower going forward, mainly due to lower energy prices. However, the picture of economic developments described in February still stands, to a large degree.

■ Low interest rate until inflation accelerates

Economic activity is now clearly strengthening but inflation is low. Monetary policy needs to remain very expansionary to contribute to inflation accelerating. The repo rate is therefore expected to remain at the current low level of 0.75 per cent for around one year. It is considered appropriate to wait until inflation accelerates before gradually raising the repo rate. At the end of the forecast period, the repo rate is expected to be 2.7 per cent.

For some time now, monetary policy has been characterised by a balance between weighing how low the repo rate needs to be for inflation to approach the target soon enough against the increased risks linked to households' high indebtedness that can stem from a low interest rate. In December last year the Riksbank cut the repo rate and the repo-rate path as inflation had been surprisingly low and inflationary pressures were assessed to be lower than forecast. At the same time, the assessment was still that household indebtedness remains a risk to sustainable long-run development. Economic activity is now clearly strengthening and household debt as a percentage of disposable income is assessed to be increasing more than in the previous forecast, while inflation has been somewhat lower than expected. The challenge involved in attaining this balance has thus been accentuated.

Compared with the Monetary Policy Report in February, the revision in the inflation forecast is minor and in the longer run is mainly due to lower energy prices. As economic activity is strengthening at the same time and inflationary pressures are expected to increase in the coming period, the revision to the inflation forecast is assessed as too small to justify an additional repo-rate cut. A lower repo rate would also increase the risks linked to the high household indebtedness.

However, it is uncertain how quickly inflation will rise, particularly given that inflation has been weaker than expected for some time. Over the past year, it has primarily been the rate of increase in service prices that has slowed down, after remaining stable at around 2 per cent for a long period of time. In addition, there is uncertainty over the driving forces behind the unexpectedly strong GDP outcome in the fourth quarter of last year. Indicators point to growth contributing to increased activity on the labour market in the coming period, which is expected to lead to higher cost pressures and rising inflation. If productivity growth were instead to be stronger than expected in the coming period, inflation might be lower. The forecast for the repo rate has therefore been adjusted down somewhat and reflects the greater probability of a repo-rate cut in the near term compared with the assessment made in February.

As the low inflation means that monetary policy can less easily be used to manage the risks linked to household indebtedness, other policy areas need to contribute more. It is now important to state in concrete terms which measures can be implemented in 2014 and thereafter. However, it is difficult to judge the effects of various macroprudential policy measures on household indebtedness. If the measures were to lead to a decline in the risks linked to household indebtedness, this would ease the monetary policy trade-offs associated with these risks. The Riksbank will, as before, monitor and analyse risks and resilience in the financial system and ascertain how these affect general economic development and thereby monetary policy.

■ New information since the February Monetary Policy Report

Financial markets

- It is possible to see that the economic recovery is continuing in the recent developments on the financial markets. Together with the expansionary monetary policy conducted by the large central banks, the recovery has contributed to an increase in the price of high-risk assets. The interest rate differentials between corporate bonds and government bonds in Europe and the United States are continuing to decline, as are the differences between government bond rates in the debt-ridden European countries and Germany. Long-term government bond rates in Europe and the United States have only marginally changed since the Monetary Policy Report was published in February. The signs of financial stress that were visible in February as a result of the foreign exchange policy unease in many emerging markets have faded without spreading to the rest of Europe and the United States. The uncertainty connected with the situation in Ukraine has so far had limited spread to the financial markets.

- The ECB, the Federal Reserve and the Bank of England have continued to assure market agents that their first interest rate increases will not come for some time yet, which is reflected in the market's monetary policy expectations. The Federal Reserve and the Bank of England are expected to raise their policy rates during the first half of 2015, according to market pricing, while the ECB is expected to raise its rate somewhat later. Since publication of the Monetary Policy Report in February, forward rates in the United States have risen in the longer run. In the euro area and the United Kingdom they have in principle remained unchanged.

- In Sweden, long-term government bond rates have largely followed international developments and only changed marginally since the Monetary Policy Report was published. Shorter government bond rates and forward rates have fallen, primarily due to the inflation outcome in January being lower, and the outcome for unemployment in February being higher, than expected. However, the unexpectedly strong GDP outcome contributed to interest rates rising, but altogether Swedish forward rates are lower than they were in mid-February.

- The rate of increase in household borrowing remained at 5.1 per cent in February, when expressed as an annual percentage change. At the same time, prices of tenant-owned apartments and single-family dwellings have continued to rise. In February, they rose by 12.9 and 6.7 per cent respectively, compared with February 2013, according to statistics from Valueguard.

- Interest rates to Swedish households fell in January and February. The average mortgage rate paid by households was 2.4 per cent in February. According to the National Institute of Economic Research’s Economic Tendency Survey, households are expecting the variable mortgage rate to remain at levels lower than the historical average during the coming years. In one year's time, the variable mortgage rate is expected to be 2.9 per cent and in five years' time, 4.0 per cent.

- Interest rates to Swedish non-financial companies rose somewhat to 2.6 per cent in February. The annual growth rate in lending to non-financial companies increased to 1.6 per cent. At the same time, companies' borrowing via the securities market is continuing to increase, both in absolute terms and as a percentage of companies' total borrowing.

International situation

- All in all, new information received since the Monetary Policy Report was published in February implies that the recovery abroad is continuing. Although global trade fell somewhat at the end of 2013, global confidence indicators such as the purchasing managers' index are continuing to show growth in both the manufacturing industry and the services sector at the beginning of 2014. However, economic developments differ somewhat from region to region. While activity is increasing in several countries in Europe, it has slowed down in, for instance, China and Russia. One cause for concern that has arisen since the monetary policy meeting in February is the situation in Ukraine. So far, it has had very limited effects on confidence indicators, energy prices and financial markets outside of Russia.

- Economic developments in the euro area are continuing to improve. GDP growth was 0.9 per cent in the fourth quarter, calculated as an annual rate, which was the third consecutive quarter with positive growth. Confidence indicators at the start of 2014 imply that activity will improve further in the coming period. Inflation in the euro area is low and amounted to 0.5 per cent in March. The underlying rate of inflation (excluding energy, food, alcohol and tobacco) amounted to 0.8 per cent in the same month.

- In the United States, activity in the economy slowed down at the beginning of the year, which is assumed to be largely due to the unusually severe winter having slowed down residential construction and turnover in the retail trade. However, the statistics published in March imply that this is temporary and surveys, such as the Federal Reserve's Beige Book, indicate that underlying economic activity is continuing to improve in most of the country's regions. The cold weather also led to somewhat higher energy prices, which contributed to pushing up inflation in January to 1.6 per cent. The upturn was temporary, however, and in February inflation fell back to 1.1 per cent.

- In China, the latest outcomes for exports, investment, industrial production and the retail trade show a slowdown in January and February. The statistics are uncertain as the outcomes have been affected by the Chinese New Year celebrations. But lower confidence in the corporate sector in recent months also indicates that growth in the Chinese economy is slowing down. Prospects for the Japanese economy in the near term are affected by the VAT increase to be implemented in April. Turnover in the retail trade rose substantially in January and February when households increased their consumption prior to the expected price increases. At the same time, consumer confidence has fallen. CPI inflation, which has risen for most of 2013, rose further to 1.5 per cent in February.

- Developments on other important Swedish export markets have been mixed. In the United Kingdom, activity has continued to improve. GDP rose by 2.7 per cent from the third to the fourth quarter of 2013, when calculated as an annual rate, and confidence indicators point to continued high growth during the first quarter. At the same time, CPI inflation has fallen and amounted to 1.7 per cent in February. In Norway, GDP grew by 2.4 per cent in the fourth quarter, compared with the third quarter and calculated as an annual rate. Norges Bank held its policy rate unchanged at 1.5 per cent at its March meeting, to support the recovery following the slowdown in growth during last year. CPI inflation fell to 2.1 per cent in February. In Denmark, GDP fell unexpectedly by 2.3 per cent from the third to the fourth quarter, calculated as an annual rate, but just as for the euro area, indicators imply that activity will improve in the coming period. CPI inflation remains low and fell to 0.5 per cent in February.

GDP in Sweden

- Swedish GDP increased by 7.1 per cent in the fourth quarter of 2013, calculated as an annual rate, which was much higher than the forecast in the February Monetary Policy Report. All components of GDP developed more strongly than expected. The fact that the outcome was strong is partly due to public consumption being high, as the defence forces made large purchases of defence materiel, and partly to substantial stockbuilding in relation to production. During the first quarter of 2014, they are expected to return to a more normal level. This contributes to the assessment that GDP growth in the first quarter of this year will slow down to 0.7 per cent, calculated as an annual rate.

- The National Institute of Economic Research’s Economic Tendency Survey fell in both February and March. In March, it was 101.5, which is just above the historical average. Since January the indicator has fallen by 5.6 units. All confidence indicators fell in March. The confidence indicators for the manufacturing industry and for the construction and civil engineering sector are now close to the historical average level, while confidence indicators for the retail trade and service industries are above their historical averages. The purchasing managers' index for the manufacturing industry is slightly higher than its historical average, while the index for the services sector is slightly lower. Services production rose in both January and February. Industrial production also increased in February, after declining in January. Construction increased rapidly in January.

- Household consumption increased by 3.7 per cent during the fourth quarter, when calculated as an annual rate. The household confidence indicator fell in February and March and is now at 99.6, that is, just below its historical level. Households' views of their own finances are more negative than normal, while the view of the Swedish economy is more optimistic than normal. Sales volumes in the retail trade and Statistics Sweden’s indicator for household consumption increased in January and February after having fallen in December. Consumption is expected to continue increasing at a strong pace in the coming quarters.

- During the fourth quarter, investment increased by 3.9 per cent, compared with the previous quarter and calculated as an annual rate. The main explanation for the increase is the continued high growth in housing investment. Statistics Sweden's survey from February implies that companies' investments will increase again somewhat in 2014, after the cutbacks in 2013. Housing investment is expected to continue to increase rapidly in 2014.

- Exports rose by 2.9 per cent during the fourth quarter, when calculated as an annual rate and imports increased by 3.3 per cent in the same quarter. The monthly statistics for trade in goods imply that both exports and imports have continued to rise at the beginning of the year. According to the National Institute of Economic Research’s Business Tendency Survey and the purchasing managers' index, export orders have increased in recent months.

Labour market

- Since the Monetary Policy Report was published in February, the Swedish labour market has been somewhat weaker than expected. Both employment and the labour force are still growing, but unemployment has been somewhat higher than expected. In February, seasonally-adjusted unemployment was 8.1 per cent.

- Indicators of the demand for labour continue to suggest that the labour market is stable, however. The number of redundancy notices is still lower than in the corresponding period in 2013 and is well below an average since 1998. Employment plans in the National Institute of Economic Research’s Business Tendency Survey for March were still at a higher level than the historical average. All in all, this indicates that companies envisage that economic activity will pick up and that this will require new recruitment.

- During the first half of 2014, employment is expected to continue rising. However, the growth rate is expected to be somewhat lower than in the February assessment and unemployment will fall only marginally.

- According to the National Accounts for the fourth quarter, the number of hours worked was weaker than the Riksbank had forecast in February, which together with the strong GDP outcome gave a high growth in productivity.

Cost pressures and inflation

- The National Mediation Office’s short-term wage statistics indicate that wages in the entire economy rose by an average of 2.4 per cent last year, calculated as an annual percentage change. The statistics are still preliminary and when all of the retroactive payments have entered into the statistics, wages are expected to have increased by 2.6 per cent. During the first half of this year wages in the economy as a whole are expected to increase somewhat faster than last year.

- According to the National Accounts, hourly wages in the economy as a whole increased by around 2.4, when calculated as an annual percentage change, during the fourth quarter of 2013, while labour costs per hour increased at a somewhat slower pace. Growth in labour productivity during the quarter was close to 3 per cent as an annual percentage change and was much stronger than in the assessment made in the February Monetary Policy Report. The high level of productivity meant that unit labour costs fell during the quarter. The fact that productivity was high was partly due to a temporary increase in demand and productivity growth is expected to slow down during the first half of this year. This in turn will contribute to a slight rise in the growth rate of unit labour costs. When expressed as an annual percentage change, unit labour costs are expected to rise slowly this year.

- Households' inflation expectations twelve months ahead fell from 1.1 per cent in January to 1.0 per cent in February and 0.9 per cent in March, according to the National Institute of Economic Research’s Economic Tendency Survey. The perceived rate of inflation has on the whole been lower at the beginning of 2014 than at the end of 2013, and amounted to 0.4 per cent in March. Money market agents' inflation expectations remained unchanged in March, according to Prospera, and amounted to 1.0 per cent one year ahead, 1.6 per cent two years ahead and 1.9 per cent five years ahead.

- Since the Monetary Policy Report was published in February, the inflation outcomes for January and February have been published. CPI inflation was -0.2 per cent and CPIF inflation 0.4 per cent in both January and February, which was lower than expected. CPIF inflation excluding energy prices was 0.8 per cent in February, which was in line with the forecast. The rate of increase in services prices is much lower now than the historical average. The rate of increase in food prices has also slowed down over the past six months. International food commodity prices fell last year, but have begun to increase in recent months.

- CPIF inflation is expected to fall to 0.3 per cent in March, when measured as an annual change. During the following months, it is expected to be just over 0.5 per cent, which is lower than in the February assessment. The forecast for the rate of increase in the CPIF excluding energy prices has been revised down marginally for the coming months, as a result of a continued weak development in service prices and the fact that unit labour costs are expected to increase more slowly this year. The rate of change in electricity prices is expected to be lower in the coming months, compared with the assessment in February. CPI inflation will be lower than CPIF inflation this year, as households' interest expenditure is expected to fall, when measured as an annual percentage change.

- Compared with February last year, producer prices of goods consumed in Sweden have fallen by 1 per cent. On the import side, prices have fallen by 1.9 per cent, but prices are not falling as quickly as in 2013. Prices on the domestic market have fallen by 0.2 per cent. The fall in prices has also slowed down there. According to the National Institute of Economic Research's Business Tendency Survey, expectations in the business sector are that prices will be raised somewhat in the coming period. The percentage of companies who expect prices to rise was higher in March than the historical average in all branches.

■ Tables

The forecast in the previous Monetary Policy Report is shown in brackets.

Table 1. Repo rate forecast
Per cent, quarterly averages

	Q4 2013	Q1 2014	Q2 2014	Q1 2015	Q1 2016	Q1 2017
Repo rate	0.8	0.8 (0.7)	0.7 (0.7)	0.7 (0.9)	2.0 (2.1)	2.7 (2.7)

Source: The Riksbank

Table 2. Inflation
Annual percentage change, annual average

	2012	2013	2014	2015	2016
CPI	0.9	0.0 (0.0)	0.2 (0.6)	2.2 (2.5)	3.2 (3.0)
CPIF	1.0	0.9 (0.9)	0.7 (0.9)	1.7 (1.8)	2.0 (2.0)
CPIF excl. energy	1.0	1.1 (1.1)	1.1 (1.1)	1.9 (1.9)	2.1 (2.1)
HICP	0.9	0.4 (0.4)	0.5 (0.9)	1.7 (1.8)	2.0 (2.0)

Note. The CPIF is the CPI with a fixed mortgage rate. HICP is an EU harmonised index of consumer prices.

Sources: Statistics Sweden and the Riksbank

Table 3. Summary of financial forecasts
Per cent, unless otherwise stated, annual average

	2012	2013	2014	2015	2016
Repo rate	1.5	1.0 (1.0)	0.7 (0.7)	1.1 (1.4)	2.3 (2.4)
10-year rate	1.6	2.1 (2.1)	2.4 (2.6)	3.2 (3.4)	3.9 (4.0)
Exchange rate, KIX, 18 Nov. 1992 = 100	106.1	103.0 (103.0)	103.0 (102.8)	101.8 (101.6)	101.2 (101.1)
General government net lending*	-0.7	-1.3 (-1.4)	-1.9 (-1.7)	-0.9 (-0.6)	-0.1 (0.1)

* Per cent of GDP

Sources: Statistics Sweden and the Riksbank

Table 4. International conditions
Annual percentage change, unless otherwise stated

GDP	PPP-weights	KIX-weights	2012	2013	2014	2015	2016
Euro area	0.14	0.47	-0.6	-0.4 (-0.4)	1.2 (1.2)	1.8 (1.8)	1.9 (1.9)
USA	0.19	0.08	2.8	1.9 (1.9)	3.1 (3.3)	3.4 (3.3)	2.7 (2.9)
Japan	0.06	0.03	1.4	1.5 (1.6)	1.2 (1.9)	1.1 (1.1)	1.2 (1.2)
China	0.15	0.07	7.8	7.6 (7.6)	7.3 (7.3)	7.0 (7.0)	7.0 (7.0)
KIX-weighted	0.79	1.00	1.0	1.1 (1.1)	2.3 (2.3)	2.7 (2.7)	2.8 (2.8)
World (PPP-weighted)	1.00	-	3.2	2.9 (2.9)	3.6 (3.7)	3.9 (3.9)	3.8 (3.9)

Note. Calendar-adjusted growth rates. PPP weights refer to the global purchasing-power adjusted GDP weights for 2012, according to the IMF. The National Institute of Economic Research updates the weights for the KIX krona index at the start of every year, with a time lag of three years. The figures in the table are based on KIX weights for 2011 that are used up to and including 2014, after that an assumption is made that the weights will develop according to the trend during the period 2007-2011.

CPI	2012	2013	2014	2015	2016
Euro area (HICP)	2.5	1.4 (1.4)	0.9 (1.0)	1.5 (1.5)	1.7 (1.7)
USA	2.1	1.5 (1.5)	1.6 (1.6)	2.1 (2.3)	2.5 (2.6)
Japan	0.0	0.4 (0.4)	2.8 (3.2)	2.0 (2.0)	1.7 (1.7)
KIX-weighted	2.6	1.9 (1.9)	1.7 (1.8)	2.2 (2.2)	2.3 (2.3)

	2012	2013	2014	2015	2016
Policy rates in the rest of the world, per cent	0.4	0.2 (0.2)	0.3 (0.3)	0.4 (0.4)	1.0 (1.0)
Crude oil price, USD/barrel Brent	111.8	108.8 (108.8)	106.1 (105.3)	101.7 (100.6)	97.9 (96.5)
Swedish export market	1.7	1.5 (1.5)	4.5 (5.4)	5.9 (6.4)	6.1 (6.8)

Note. The export market aims to measure demand for imports in the countries to which Sweden exports. This is calculated by aggregating the imports of 32 countries and covers around 85 per cent of the Swedish export market. The weights comprise the respective country´s share of Swedish export of goods. Policy rates in the rest of the world refer to a weighted average of USA, the euro area, Norway and the United Kingdom.

Sources: Eurostat, IMF, Intercontinental Exchange, National sources, OECD and the Riksbank

Table 5. GDP by expenditure

Annual percentage change, unless otherwise stated

	2012	2013	2014	2015	2016
Private consumption	1.6	2.0 (1.7)	2.9 (2.8)	2.9 (3.5)	2.5 (2.6)
Public consumption	0.3	2.0 (1.2)	0.9 (0.8)	1.6 (1.2)	1.2 (1.1)
Gross fixed capital formation	3.3	-1.3 (-1.2)	4.2 (3.7)	6.9 (7.2)	5.3 (5.4)
Inventory investment*	-1.2	0.2 (-0.1)	0.2 (0.3)	0.0 (0.0)	0.0 (0.0)
Exports	0.7	-0.9 (-1.7)	4.2 (2.2)	6.2 (6.5)	6.3 (6.7)
Imports	-0.6	-1.2 (-2.2)	4.5 (3.1)	6.8 (6.9)	6.6 (7.2)
GDP	0.9	1.5 (0.9)	2.7 (2.4)	3.2 (3.6)	2.8 (2.8)
GDP, calendar-adjusted	1.3	1.5 (0.9)	2.8 (2.5)	3.0 (3.4)	2.5 (2.5)
Final figure for domestic demand*	1.5	1.2 (0.9)	2.4 (2.3)	3.2 (3.4)	2.6 (2.6)
Net exports*	0.6	0.1 (0.1)	0.1 (-0.2)	0.1 (0.2)	0.2 (0.2)
Current account (NA), per cent of GDP	6.5	6.6 (6.2)	6.6 (5.7)	6.3 (5.5)	6.2 (5.4)

*Contribution to GDP growth, percentage points

Note. The figures show actual growth rates that have not been calendar-adjusted, unless otherwise stated. NA is the National Accounts.

Sources: Statistics Sweden and the Riksbank

Table 6. Production and employment

Annual percentage change, unless otherwise stated

	2012	2013	2014	2015	2016
Population, aged 16–64	0.6	0.6 (0.6)	0.7 (0.7)	0.7 (0.7)	0.7 (0.7)
Potential hours worked	0.5	0.5 (0.5)	0.6 (0.6)	0.6 (0.6)	0.6 (0.6)
GDP, calendar-adjusted	1.3	1.5 (0.9)	2.8 (2.5)	3.0 (3.4)	2.5 (2.5)
Number of hours worked, calendar-adjusted	0.6	0.4 (0.5)	1.0 (1.3)	1.6 (1.4)	1.2 (1.0)
Employed, aged 15–74	0.6	1.1 (1.1)	1.0 (1.2)	1.2 (1.1)	1.0 (0.9)
Labour force, aged 15–74	0.8	1.1 (1.1)	0.9 (0.9)	0.5 (0.4)	0.4 (0.3)
Unemployment, aged 15–74 *	8.0	8.0 (8.0)	7.9 (7.8)	7.3 (7.2)	6.7 (6.6)

* Per cent of the labour force

Note. Potential hours refer to the long-term sustainable level for the number of hours worked according to the Riksbank's assessment.

Sources: Statistics Sweden and the Riksbank

Table 7. Wages and labour costs for the economy as a whole

Annual percentage change, calendar-adjusted data unless otherwise stated

	2012	2013	2014	2015	2016
Hourly wage, NMO	3.0	2.6 (2.6)	2.8 (2.8)	3.1 (3.1)	3.4 (3.4)
Hourly wage, NA	3.1	2.4 (2.2)	2.9 (2.9)	3.3 (3.3)	3.7 (3.7)
Employers' contribution*	0.3	-0.1 (-0.1)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)
Hourly labour cost, NA	3.4	2.3 (2.2)	2.9 (2.9)	3.3 (3.3)	3.7 (3.7)
Productivity	0.7	1.1 (0.4)	1.9 (1.2)	1.4 (1.9)	1.3 (1.6)
Unit labour cost	2.7	1.2 (1.8)	1.0 (1.8)	1.9 (1.4)	2.3 (2.1)

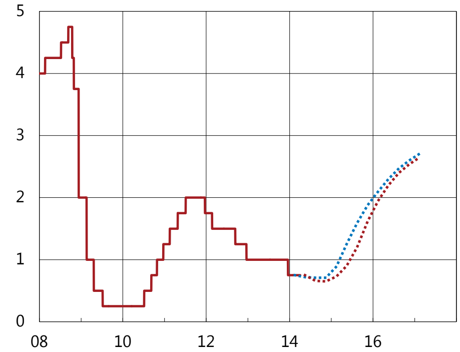
* Contribution to the increase in labour costs, percentage points

Note. NMO is the National Mediation Office's short-term wage statistics and NA is the National Accounts. Labour cost per hour is defined as the sum of actual wages, social-security charges and wage taxes divided by the seasonally adjusted total number of hours worked. Unit labour cost is defined as labour cost divided by seasonally-adjusted value added at constant prices.

Sources: National Mediation Office, Statistics Sweden and the Riksbank

Figures

Figure 5. Repo rate
Per cent

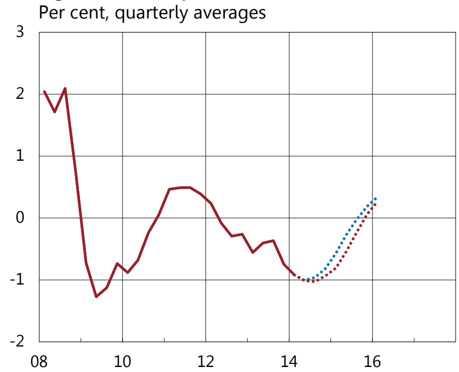


April
February

Note. Outcome data are daily rates and forecasts are quarterly averages.

Source: The Riksbank

Figure 6. Real repo rate
Per cent, quarterly averages

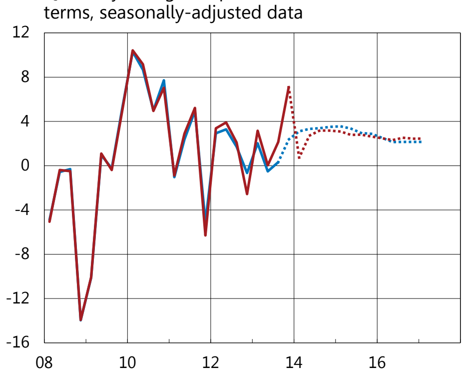


April
February

Note. The real repo rate is calculated as an average of the Riksbank's repo rate forecasts for the coming year minus the inflation forecast (CPIF) for the corresponding period.

Source: The Riksbank

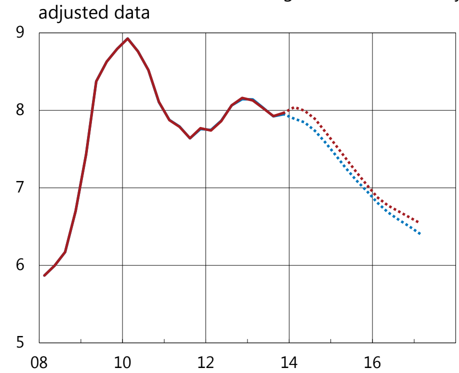
Figure 7. GDP
Quarterly changes in per cent calculated in annualised terms, seasonally-adjusted data



April
February

Sources: Statistics Sweden and the Riksbank

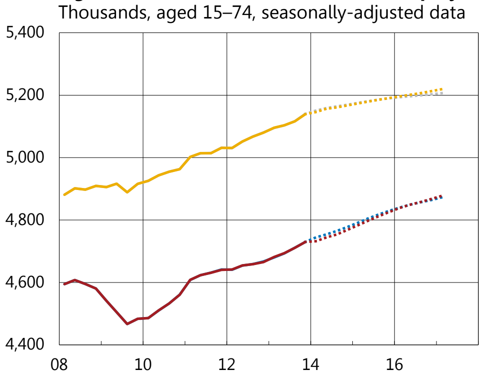
Figure 8. Unemployment
Per cent of the labour force, aged 15–74, seasonally-adjusted data



April
February

Sources: Statistics Sweden and the Riksbank

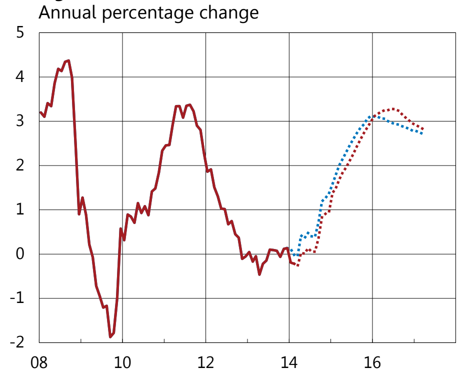
Figure 9. Labour force and number of employed
Thousands, aged 15–74, seasonally-adjusted data



Employed, April
Employed, February
Labour force, April
Labour force, February

Sources: Statistics Sweden and the Riksbank

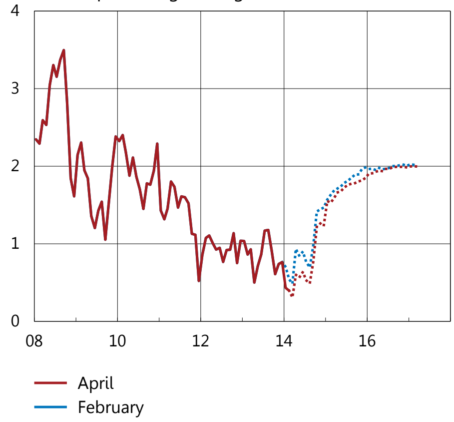
Figure 10. CPI
Annual percentage change



April
February

Sources: Statistics Sweden and the Riksbank

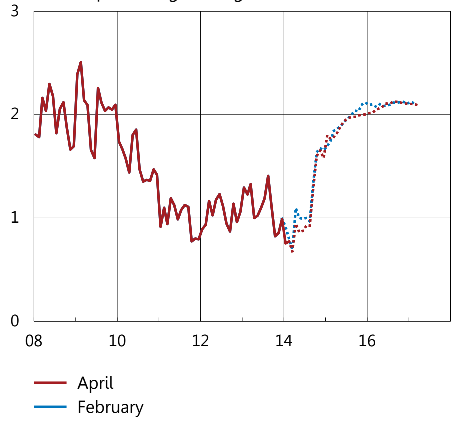
Figure 11. CPIF
Annual percentage change



Note. The CPIF is the CPI with a fixed mortgage rate.

Sources: Statistics Sweden and the Riksbank

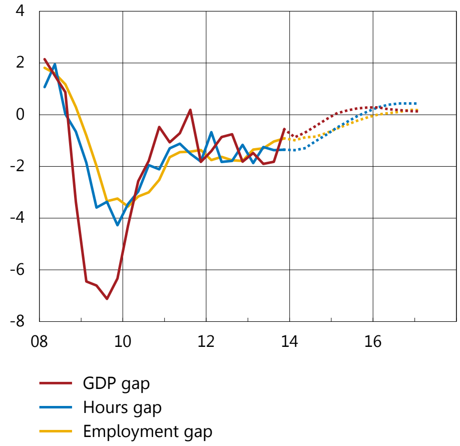
Figure 12. CPIF excluding energy
Annual percentage change



Note. The CPIF is the CPI with a fixed mortgage rate.

Sources: Statistics Sweden and the Riksbank

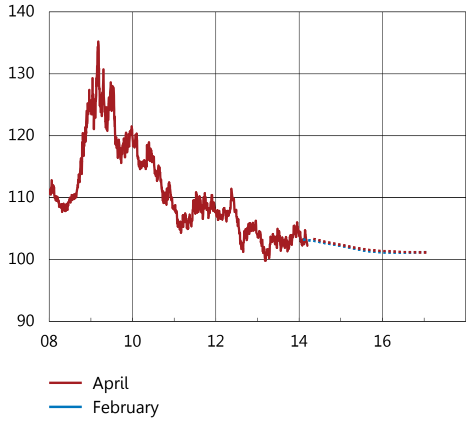
Figure 13. GDP gap, hours gap and employment gap
Per cent



Note. GDP gap refers to the deviation from trend in GDP calculated using a production function. The hours gap and the employment gap refers to the deviation in the number of hours worked and the number of those employed from the Riksbank's assessed trend.

Sources: Statistics Sweden and the Riksbank

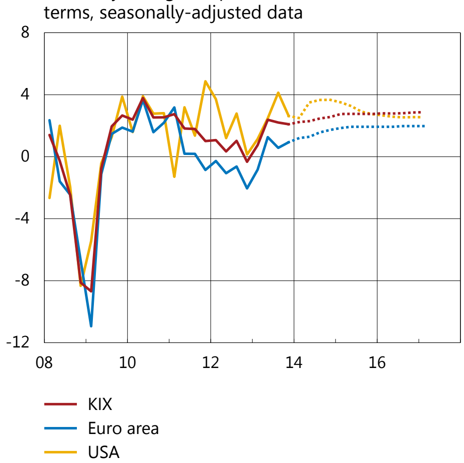
Figure 14. KIX-weighted nominal exchange rate
Index, 18 November 1992 = 100



Note. Outcomes are daily rates and forecasts refer to quarterly averages. KIX is an aggregate of countries that are important for Sweden's international transactions.

Source: The Riksbank

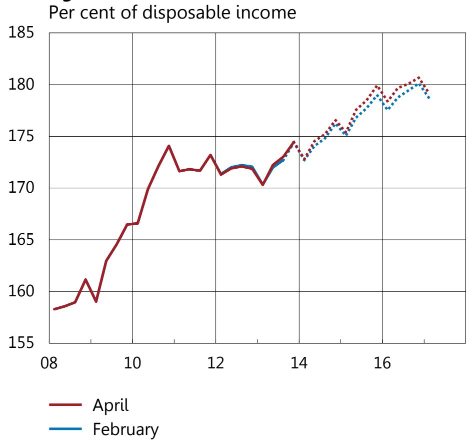
Figure 15. GDP in different regions and countries
Quarterly changes in per cent calculated in annualised terms, seasonally-adjusted data



Note. KIX is an aggregate of countries that are important for Sweden's international transactions.

Sources: Bureau of Economic Analysis, Eurostat, national sources and the Riksbank

Figure 16. Household debt
Per cent of disposable income



Sources: Statistics Sweden and the Riksbank