



Sweden needs its inflation target

Fores
13 October

Deputy Governor Martin Flodén

Why an inflation target?

- Benchmark for expectations in the economy
 - Makes it easier for households and companies to make financial decisions
 - Lays the foundation for efficient price-setting and wage formation
 - Thereby creates conditions for good and long-term sustainable growth

The inflation target is the economy's nominal anchor

Credible inflation target



Better price and
wage formation



The inflation target is the economy's nominal anchor

Credible inflation target

Better price and wage formation



Easier to attain the inflation target

Monetary policy can be more flexible



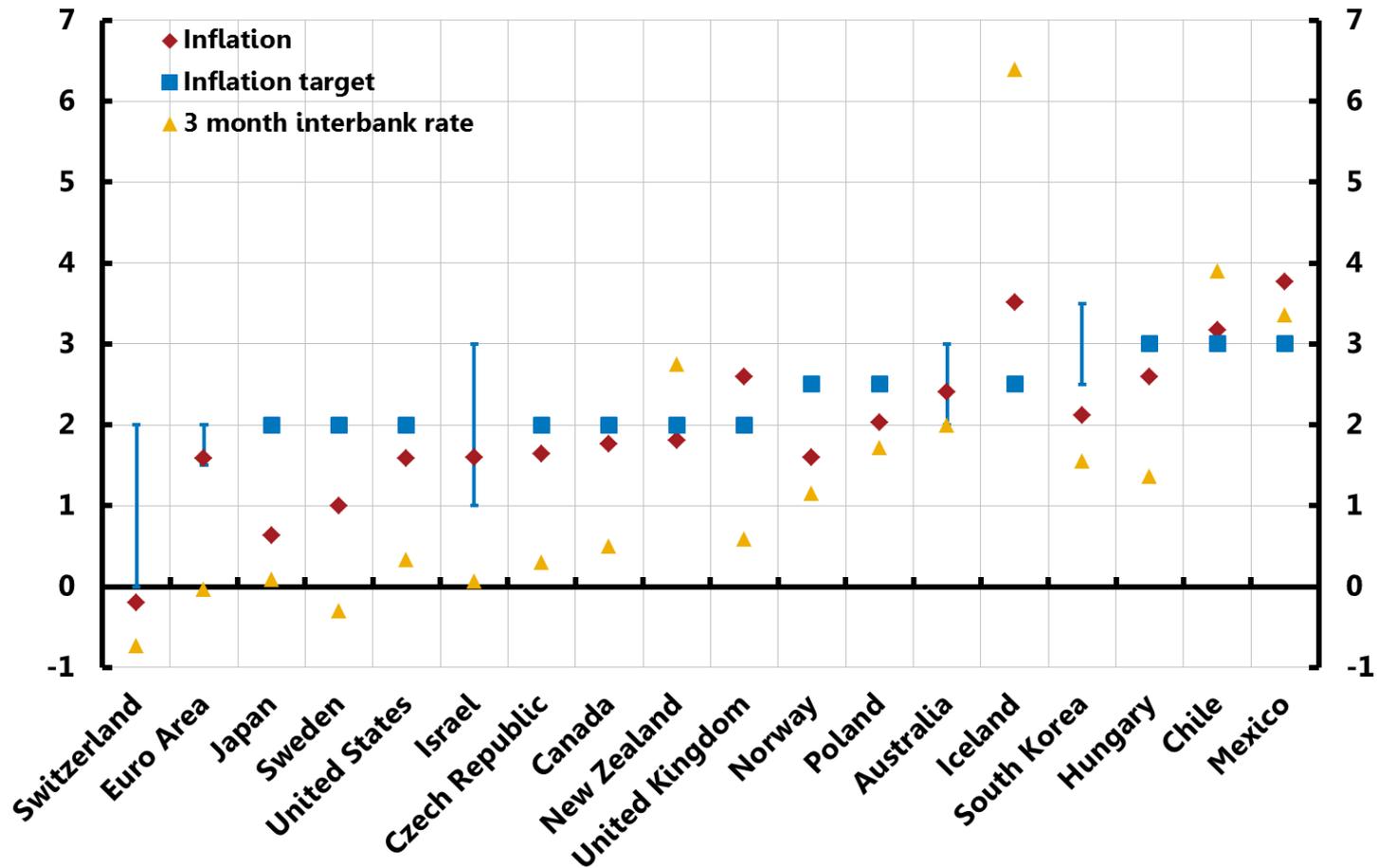
Why 2 per cent?

- The important thing is to have a target - something to guide price and wage formation

2 per cent:

- Gives monetary policy scope to take action
- Gives scope for adjustments in prices and wages
- Common inflation target internationally
 - Around 60 central banks have some kind of inflation target
 - Only Switzerland has a lower target than Sweden (to some extent also ECB and Israel)

Many countries have an inflation target of 2 per cent



Note: Inflation refers to average inflation over the period 2010 Q3–2015 Q2. CPIF inflation for Sweden. Japan introduced an inflation target in 2013 and the US in 2012. Vertical blue line indicates that the target is formulated as an interval. Interbank rate refers to average for September. Policy rate is used for Australia, Canada and New Zealand.

Sources: Eurostat and national sources

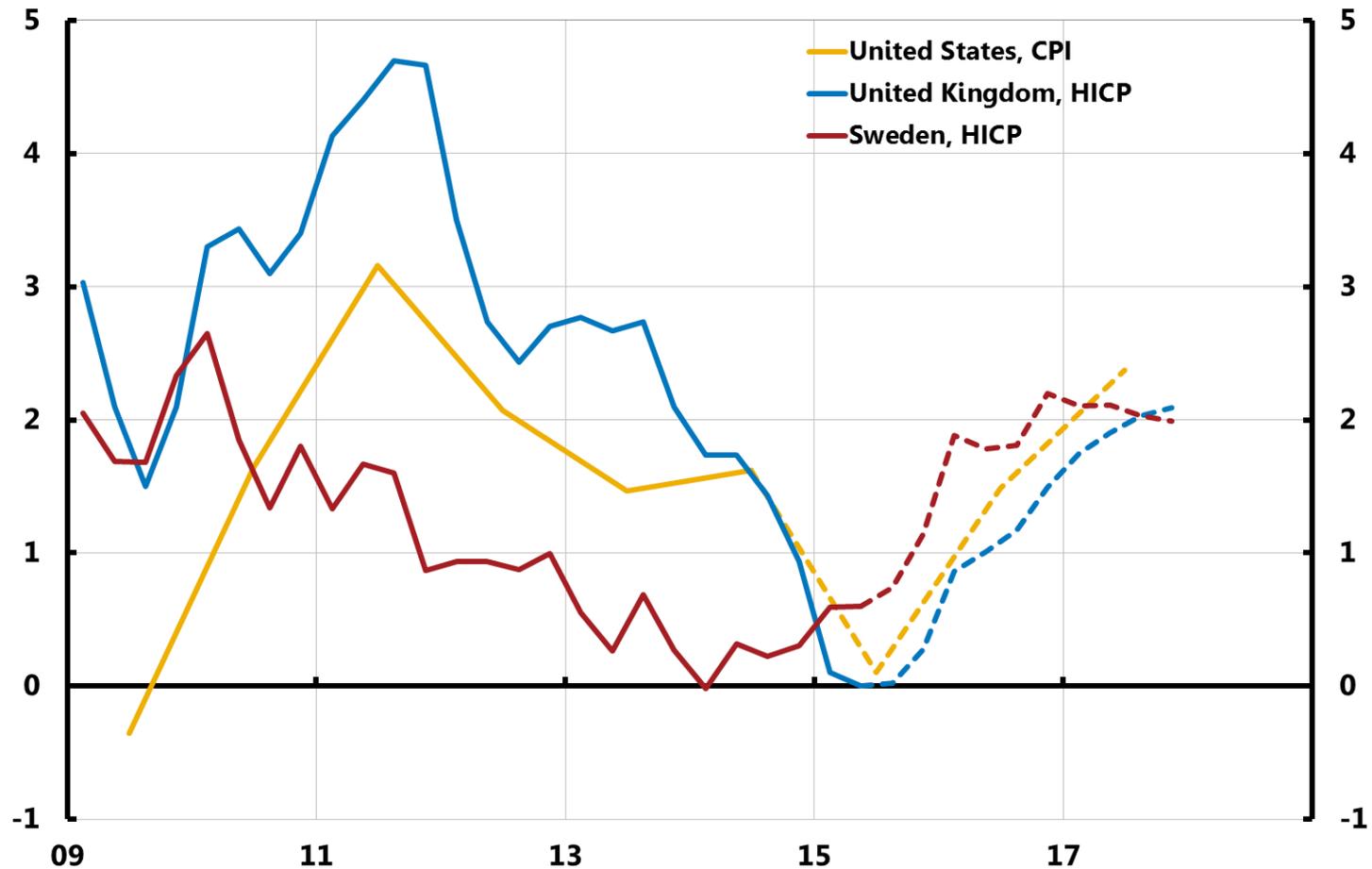
Criticism of monetary policy

- "The Riksbank should reconsider its policy. Attaining the inflation target is more or less impossible."
 - "The Riksbank should lower the inflation target or accept that inflation will continue to remain below the target for a long time."
 - "Then the repo rate could be raised and the rise in debt and housing prices would be curbed."
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Bad idea to lower the target

- Digitisation and globalisation do not lead to permanently low inflation
 - Margins cannot fall forever - temporary effect
 - Inflation is determined by monetary policy in the long term
 - Mainly a Swedish debate - in the US and UK for example, inflation is expected to reach 2 per cent

Temporarily low inflation abroad



Note. Annual percentage change. HICP refers to the EU-harmonised index for consumer prices. Quarterly data for Sweden and the UK, annual data for the US.

Sources: Bank of England, Bureau of Labor Statistics, Eurostat, IMF, Statistics Sweden and the Riksbank

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 - Margins cannot fall forever - temporary effect
 - Inflation is determined by monetary policy in the long term
 - Mainly a Swedish debate - in the US and UK for example, inflation is expected to reach 2 per cent
 - Risky to change a target because it is hard to achieve
 - Reduces confidence in the policy as it stands
 - Important to have room for the rate to fall
 - Less risk of hitting the lower limit - more room to stimulate
 - Hard to cut nominal wages - some inflation acts as a lubricant
 - Internationally: "Consider *raising* the inflation target!"
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"Keep the target but accept low inflation for longer"

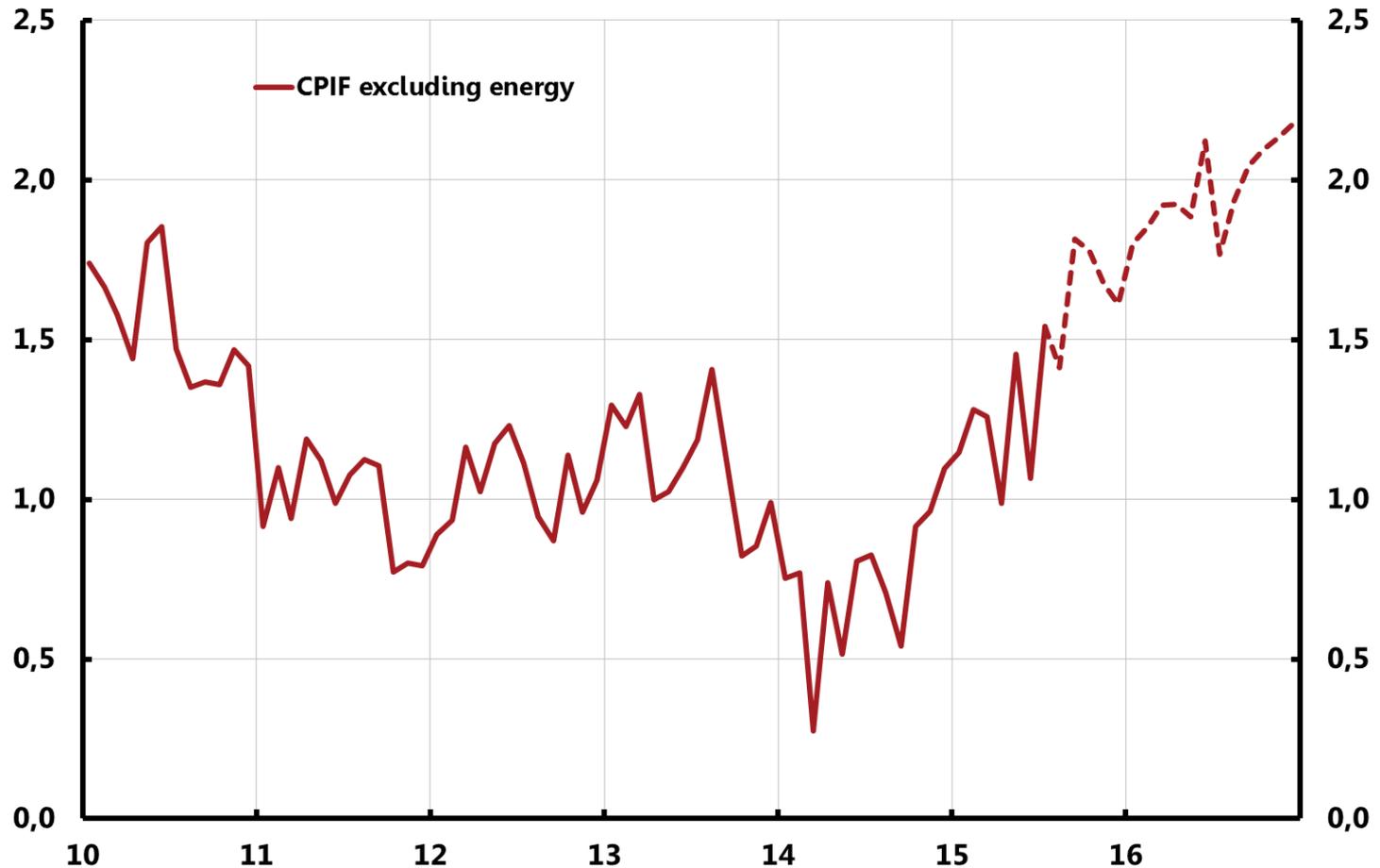


- Inflation has already been low for a long time
 - Monetary policy is flexible - it is not a question of fine-tuning



Inflation has been low for a long time

The CPIF excluding energy, annual percentage change



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

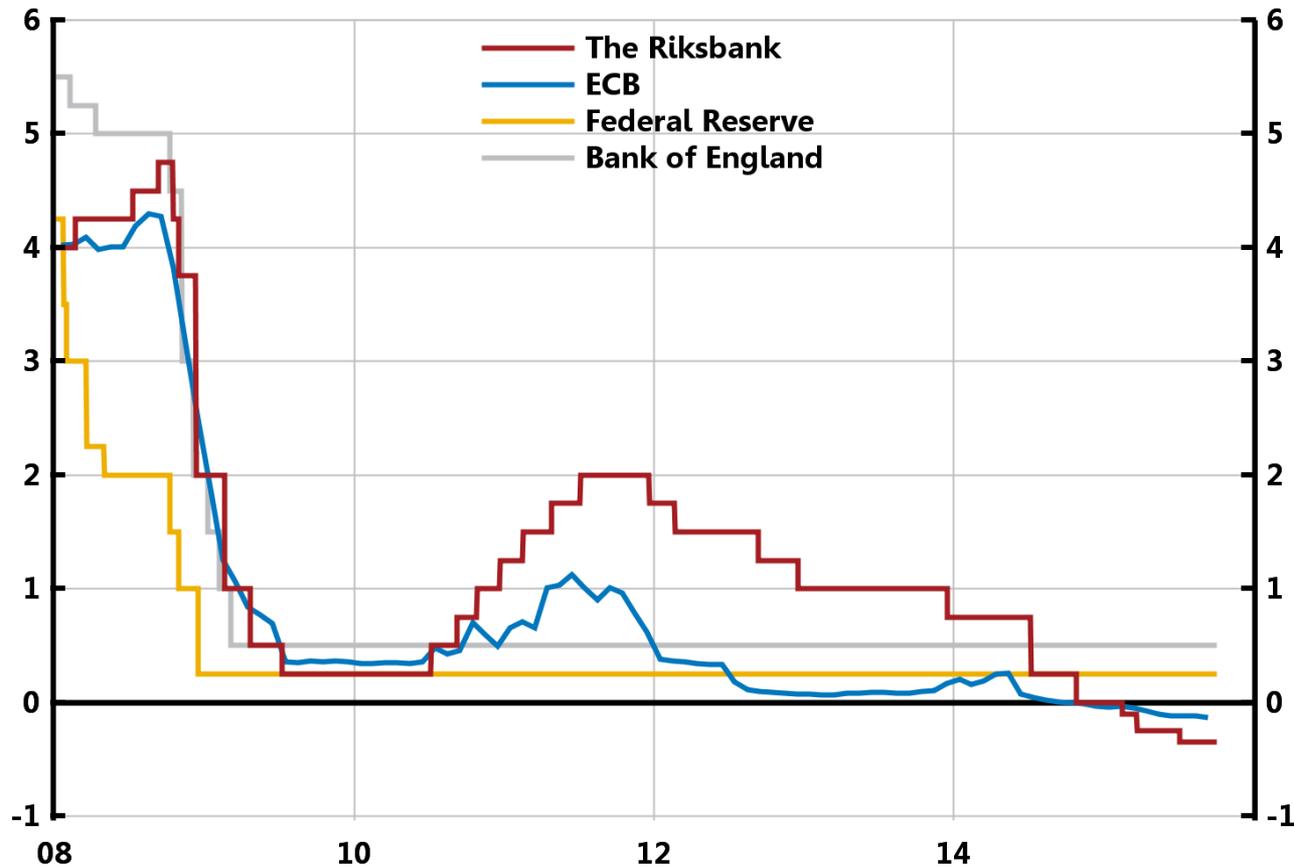
Sources: Statistics Sweden and the Riksbank

"Keep the target but accept low inflation for longer"

- Inflation has already been low for a long time
 - Monetary policy is flexible - it is not a question of fine-tuning
 - Hard to maintain confidence in the target simply through communication
 - Long-term inflation expectations have fallen
 - Fall curbed by clearly expansionary policy, rising inflation
 - Higher repo rate leads to weaker growth
 - Low interest rates internationally
 - Higher interest rates in Sweden - stronger krona, lower inflation
 - Even lower inflation expectations
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Record-low policy rates internationally

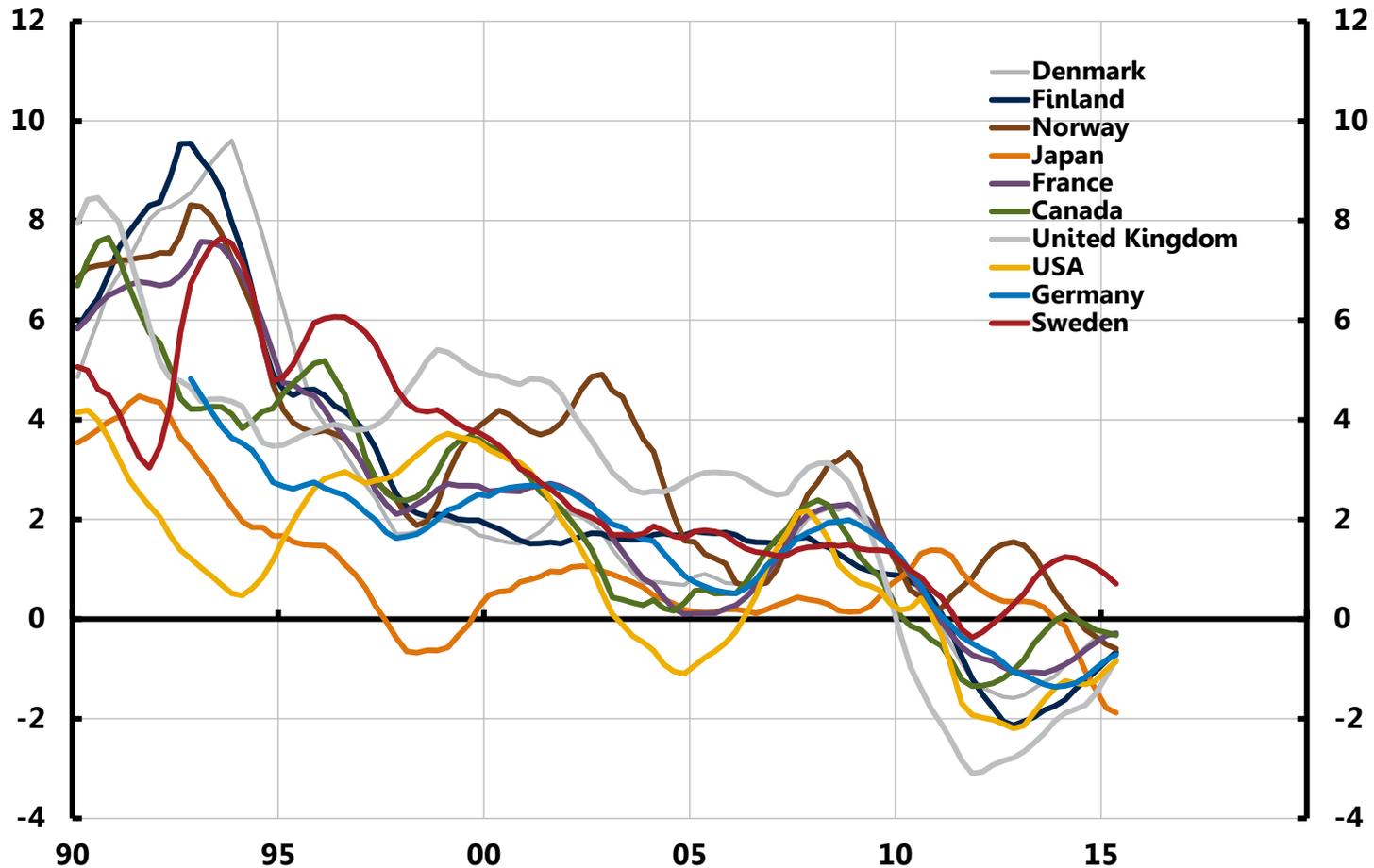
Per cent



Note. ECB refers to EONIA and is a monthly average.

Sources: The Bank of England, the ECB, the Federal Reserve Bank of New York and the Riksbank

International real interest rates have fallen



Note. Quarterly data, two-year moving average.

Source: The OECD and the Riksbank

The tolerance band was not a target range



- Removed in 2010
- Was a pedagogical tool
 - Clarified that the Riksbank neither can nor wants to hit 2 per cent inflation all the time
 - Did not influence monetary policy decisions
 - Even larger (temporary) deviations from 2 per cent could be warranted
- Inflation target was thus not 2 percentage points-wide

But what about rising debt and housing prices?



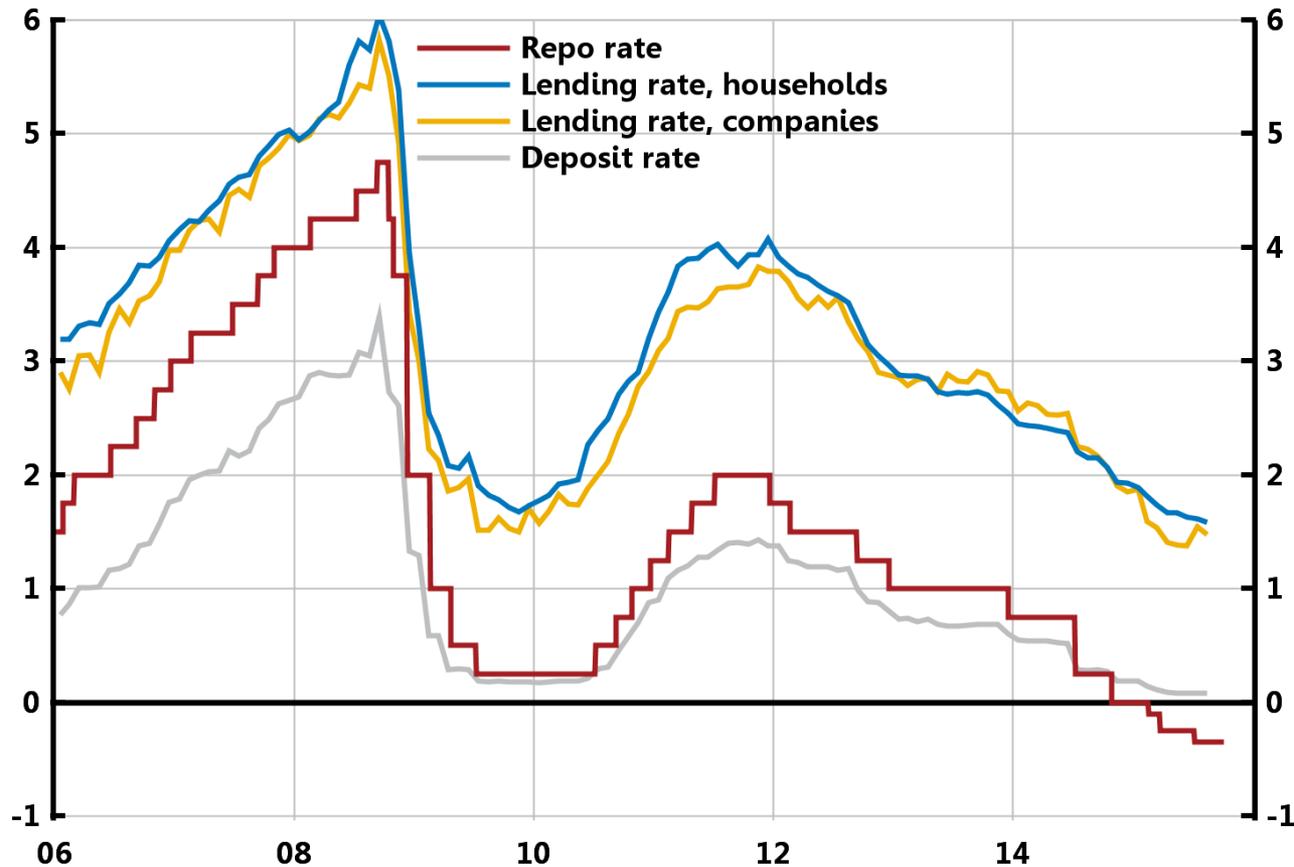
- Worrying development that the Riksbank has warned about for a long time
- Current monetary policy still justified
 - Repo rate blunt tool, other tools more suitable
 - Considerably higher interest rate would likely be needed, with lower growth and inflation as a result
 - A more normal interest rate level requires higher inflation and inflation expectations

Monetary policy having an effect despite strong headwinds

- Repo rate cuts have had an impact on market rates
 - No major disruptions on the markets due to negative rate
 - Inflation appears to be on its way up
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The repo rate influences lending rates

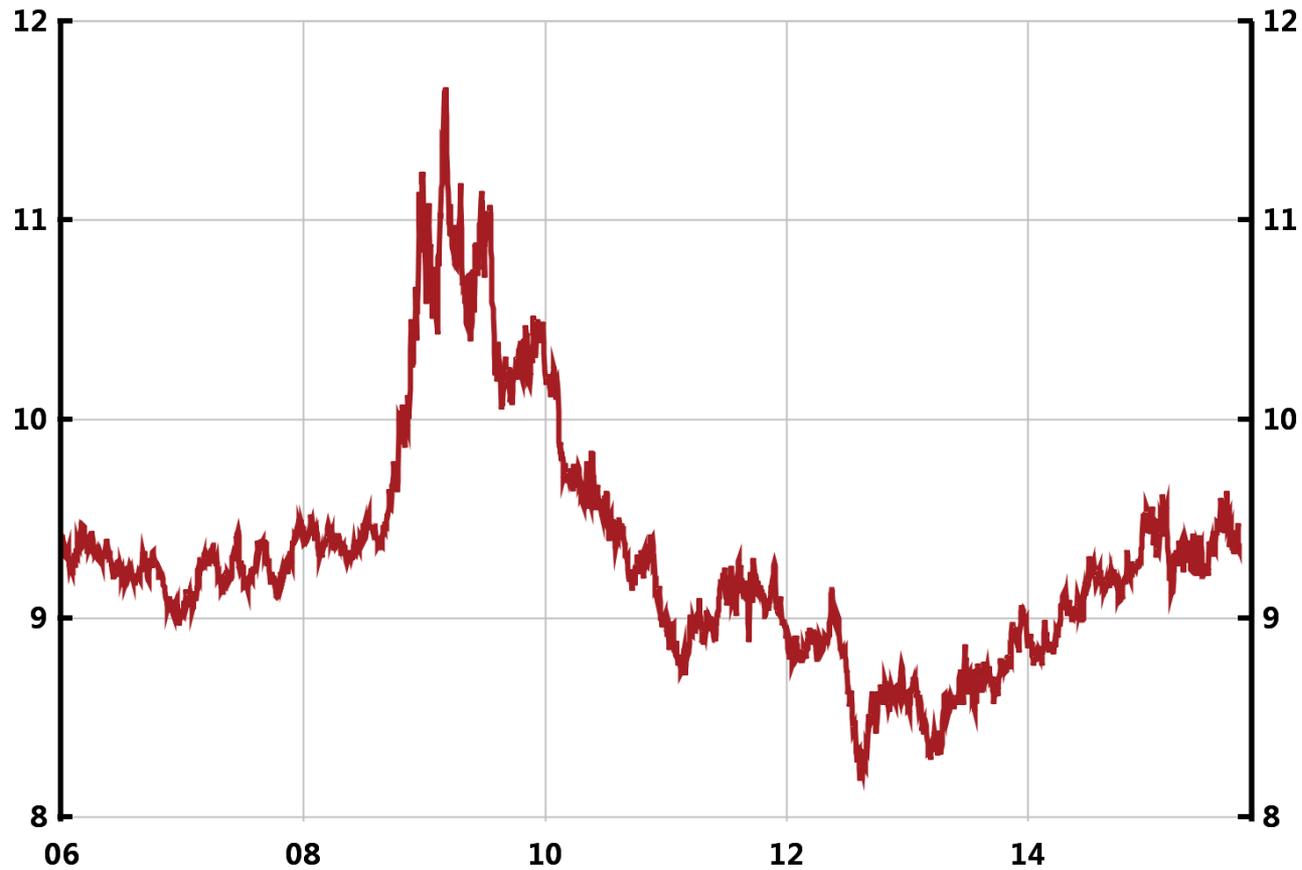
Per cent



Note. The lending rate to households refers to loans for housing purposes. Deposit rate refers to households and companies.

Sources: Statistics Sweden and the Riksbank

... and the exchange rate SEK/EUR



Note. Broken lines mark monetary policy decisions in 2015.

Sources: Macrobond and the Riksbank

Risks to the rise in inflation

**Low inflation for a long
time**

How quickly will inflation
rise?

**Concerns in emerging
economies**

Fall in oil price

**Central banks out of
step**

Rapid appreciation of
the krona - a risk to the
rise in inflation

Continued high level of preparedness

- Important that the upward trend in inflation continues
- Ready to act even between ordinary meetings

