

**Statement by Kai Aaen Hansen, Executive Director  
for Sweden  
August 25, 1999**

First, my Swedish authorities convey their appreciation to the staff for constructive discussions in Stockholm and for an accurate and balanced report.

The recovery of the Swedish economy is strong. For the first half of 1999 GDP grew by 3.7 percent, considerably stronger than anticipated in earlier forecasts. The strong recovery is expected to continue through the year, pointing to a GDP growth well above 3 percent for 1999. The growth is balanced, with a strong development of domestic demand, in particular private consumption, being reinforced by a stronger than expected increase in exports.

Inflationary pressures continue to be low, which in combination with a high credibility of economic policy, has permitted a continued, supportive stance of monetary policy.

**Fiscal Policy**

The fiscal consolidation program has led to a strong structural improvement of the public finances. To secure the gains of fiscal consolidation, the government and the parliament have adopted a medium term goal of a general government surplus of 2 percent of GDP per year over the cycle. Intermediate targets were initially set at 0.5 percent of GDP in 1999, 1.5 percent in 2000 and 2.0 percent in 2001. In the fall of 1998, the intermediate target for year 2000 was raised to 2 percent of GDP and in the Spring Budget Bill of 1999 a goal of 2.0 percent was set also for 2002.

The system of rolling three-year expenditure ceilings is an important pillar for controlling public expenditure. In the Spring Budget Bill of 1999 the government made the assessment that there was some risk that the expenditure ceilings for 1999 and 2000 would be exceeded. To keep public expenditures under the expenditure ceiling, a number of savings measures, amounting to a total of 7 billion SEK, were introduced. In addition, the government decided on limitation amounts for certain appropriations. The government is prepared to take further steps if necessary to ensure that the expenditure ceiling is maintained.

With unchanged policies, current projections indicate substantial surpluses in the public finances for the coming years, creating room for maneuver for the government. One possibility is to reduce taxes. The government also continues to give priority to secure the quality of health care, education and social services. The magnitude of this room for

maneuver will continuously be assessed against the development of the cycle to avoid an inappropriately expansive fiscal stance should the economy approach full capacity.

### **Monetary Policy**

Monetary policy in 1998-99 has been conducted against the background of a gradually shrinking output gap and subdued inflationary expectations. Substantial transitory effects on headline inflation from changes in mortgage interest costs and changes in indirect taxes have contributed to low headline inflation and a rate below the tolerance range of the inflation target. The Riksbank agrees with the staff that, the monetary stance at present is well balanced, although it recognizes that bottlenecks and inflationary pressures could emerge should recent indications of strong growth continue.

One aspect of monetary policy formulation in Sweden discussed in the staff report is how to define an inflation goal in relation to transitory effects. It is a problem familiar to all central banks using an inflation target and it has been analyzed thoroughly within the Riksbank.

In January 1999 the Riksbank gave explicit advice on how the CPI objective should be interpreted. While monetary policy will continue to be conducted with a view to stabilizing CPI inflation at 2 percent over one to two years, the Riksbank will normally disregard transitory factors stemming from e.g. changes in mortgage interest costs and indirect taxes. To facilitate an evaluation of monetary policy the Riksbank will make clear, when policy decisions are taken, which transitory effects it forecasts and disregards. An example is the Riksbank's inflation report in June, where it was stated that in practice monetary policy at present is based on an assessment of underlying inflation as measured by UND1X. The difference between CPI and UND1X is that the latter excludes transitory effects from changes in indirect taxes, subsidies and interest rates. The inflation report also contained a forecast for inflation as measured by this definition.

The Riksbank is also considering a reformulation of the inflation target, in line with the recommendation by the staff. However it is important to recognize that all known inflation measures have defects. Therefore, the Riksbank await ongoing work by a CPI inquiry appointed by the government to obtain assistance in the specification of an adequate indicator of underlying inflation as well as the process of finalizing the composition of the EU's Harmonized Index of Consumer Prices. Even after a possible revision of the target variable, the clarification presented in January will be useful.

## **Structural Policies**

The labor market situation continues to improve. Open unemployment is now around 5.5 percent, down one percentage point compared to a year ago. Employment growth is very strong, currently increasing at a rate above 2 percent annually.

It is important to ensure that the current labor market improvement can continue without giving rise to inflationary pressures. Thus, emphasis is put on measures that help prevent bottlenecks in the labor market and to curb inflationary pressures in the current upswing. Education and training measures are expected to significantly promote employability, the number of people in active labor market programs is being reduced, while at the same time there is increased emphasis on the needs of the labor market in the design of these programs. The unemployment insurance rules are subject to review, in order to identify changes that will promote job search incentives and labor mobility.

The wage formation is key to a lasting reduction of unemployment. The main responsibility for wage formation lies with the social partners. Later in the fall the government will present a bill with proposals on, inter alia, strengthened mediation procedures.

To sum up, my Swedish authorities agree with the staff that, for the time being, the fiscal and monetary stance is well balanced, although they recognize that bottlenecks and inflationary pressures could emerge should the current strong growth rate continue. Moreover, they agree with the staff report that further measures may be needed in order to foster a sustainable, high growth rate.