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Monetary Department
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CZECH NATIONAL BANK

In this issue

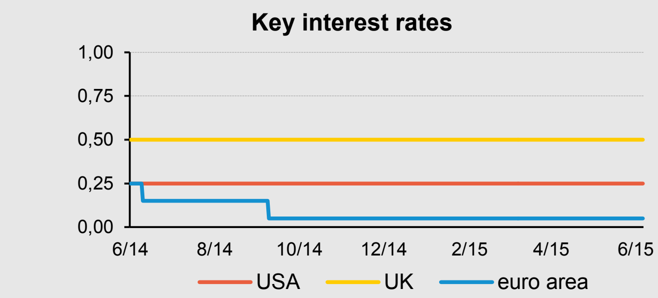
The big wave of interest rate cuts to negative levels made by some central banks came to a halt in the last quarter. Only the Riksbank lowered its repo rate further into negative territory. It also extended its purchases of government bonds in March and April. In a press release after the monetary meeting it mentioned forex interventions among potential additional measures for the first time. The NBP did not ease the monetary conditions, while the MNB lowered its policy rates three times in a row. The Fed is likely to tighten monetary policy in the second half of this year. The current Spotlight *focuses on the monetary policy of the Indian central bank, which joined the club of inflation-targeting banks in its 80th birthday year. In our* Selected Speech*, Riksbank Deputy Governor Henry Ohlsson points out the importance of the inflation target for price-setting, wage bargaining, anchoring of inflation expectations and long-term economic growth.*

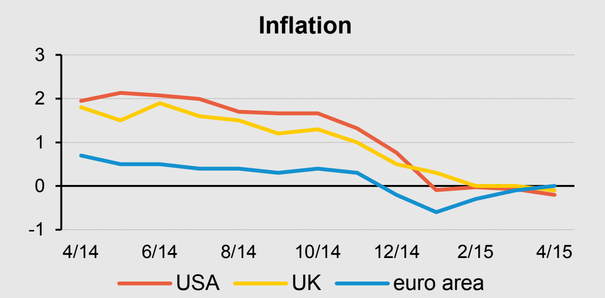
1. LATEST MONETARY POLICY DEVELOPMENTS AT SELECTED CENTRAL BANKS

Key central banks of the Euro-Atlantic area

	Euro area (ECB)	USA (Fed)	United Kingdom (BoE)
Inflation target	< 2%[1]	< 2%[2]	2%
MP meetings (rate changes)	2 Apr (0.00) 7 May (0.00) 3 Jun (0.00)	17–18 Mar (0.00) 28–29 Apr (0.00)	8–9 Apr (0.00) 8–11 May (0.00) 3–4 Jun (0.00)
Current basic rate	0.05%	0–0.25%	0.50%
Latest inflation	0.3% (May 2015)[3]	-0.2% (Apr 2015)	-0.1% (Apr 2015)
Expected MP meetings	2 Jul 6 Aug 3 Sep	16–17 Jun 28–29 Jul 16–17 Sep	8–9 Jul 5–6 Aug 9–10 Sep
Other expected events	3 Sep: publication of forecast	15 Jul: publication of Beige Book	6 Aug: publication of Inflation Report
Expected rate movements[4]	→	↑	→

[1] ECB definition of price stability "below but close to 2%"; [2] January 2012 definition of inflation target; [3] flash estimate; [4] direction of expected change in rates in coming quarter taken from Consensus Forecast survey.





The **ECB** kept its interest rates unchanged. Its asset purchase programme will run until the end of September 2016 (in the amount of EUR 60 billion per month). The quantitative easing exit strategy was not discussed; the ECB announced a temporary "seasonal" increase in purchases in May (see *News* for details). Quarterly GDP growth was 0.4% in 2015 Q1, driven mainly by private consumption. The June economic activity projection is virtually unchanged from March and foresees real GDP increasing by 1.5% in 2015, 1.9% in 2016 and 2.0% in 2017. Inflation is expected to remain low initially and then rise towards the end of the year. The inflation projections have been revised upwards for 2015 (to 0.3%) and remain unchanged for 2016 and 2017 (at 1.5% and 1.8% respectively). Currently inflation returned above zero level.

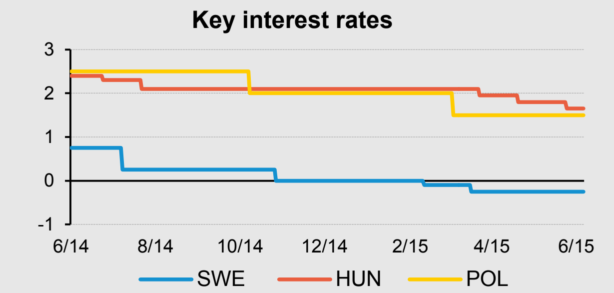
The **Fed** is continuing to keep interest rates in the range of 0.0% and 0.25% and to reinvest principal payments from its holdings of agency debt and agency mortgage-backed securities. Maturing Treasury securities are being rolled over. The minutes of the Fed's April meeting indicate that rates could be raised in 2015 H2. The FOMC members believe the weakness in GDP growth observed in Q1 to be transitory. Growth in employment slowed in Q1, but the FOMC expects labour market indicators to move toward levels consistent with the Fed's dual mandate. Household consumption declined, but households' real incomes rose strongly, partly reflecting earlier declines in energy prices, and consumer sentiment remained high.

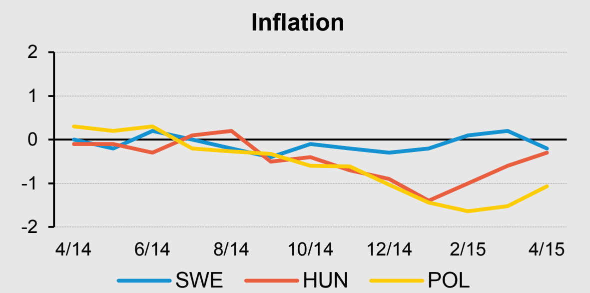
The **BoE** left its key interest rate at 0.50% and also maintained the size of its securities holdings (GBP 375 billion). Annual GDP growth was 2.4% in Q1 according to the second revised estimate. This growth was fostered by household and government consumption and gross capital formation (investment in particular). The slightly negative inflation (-0.1% in April) is in line with the expectations of the BoE, which had forecasted a dip into negative territory in the spring months and an increase towards the end of the year.

Selected central banks of inflation-targeting EU countries

	Sweden (Riksbank)	Hungary (MNB)	Poland (NBP)
Inflation target	2%	3%	2.5%
MP meetings (rate changes)	18 Mar (-0.15) 28 Apr (0.00)	25 Mar (-0.15) 21 Apr (-0.15) 26 May (-0.15)	14–15 Apr (0.00) 5–6 May (0.00) 2–3 Jun (0.00)
Current basic rate	-0.25%	1.65%	1.50%
Latest inflation	-0.2% (Apr 2015)	-0.3% (Apr 2015)	-1.1% (Apr 2015)
Expected MP meetings	1 Jul 2 Sep	23 Jun 21 Jul 25 Aug	7–8 Jul 18 Aug 1–2 Sep
Other expected events	2 Jul: publication of Monetary Policy Report	23 Jun: publication Quarterly Report on Inflation	mid-Jun: publication of Inflation Report
Expected rate movements[1]	→	→	→

[1] Direction of expected change in rates in coming quarter taken from Consensus Forecast survey.





At its March meeting, the **Riksbank** lowered its main policy rate (the repo rate) further into negative territory (to -0.25%) and announced that it would remain at this level at least until 2016 H2. The Riksbank also decided to buy government bonds for SEK 30 billion (on top of previous purchases of SEK 10 billion) and said it was ready to use additional instruments to ease the monetary conditions and hit the inflation target (potential further rate cuts, an expansion of its government bond purchase programme or a programme for loans to companies via banks). In contrast to the February meeting, it also mentioned the possibility of forex interventions to weaken the Swedish currency. At the April meeting, the repo rate was not cut, but planned government bond purchases were doubled to SEK 80–90 billion. The Riksbank will thus buy government bonds accounting for 13%–15% of the amount traded in the secondary market.

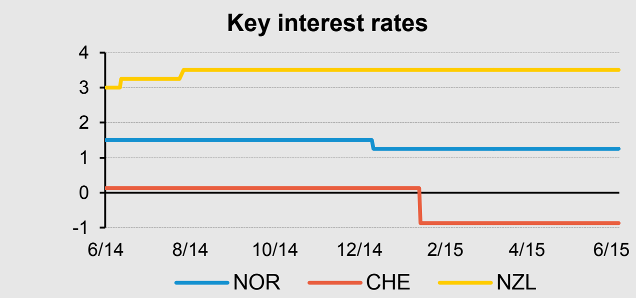
The **MNB** lowered its monetary policy rate by 0.15 pp three times in the past quarter, to 1.65%. Preliminary GDP data for 2015 Q1 suggest dynamic economic growth driven mainly by industry and retail sales. The MNB continues to expect low inflation owing to persisting disinflationary effects from the domestic real economy. According to the MNB forecast, inflation will approach the 3% target towards the end of the current forecast period, i.e. the start of 2017. The MNB announced a change in the definition of its key monetary policy rate from the two-week to the three-month rate (see *News* for more details).

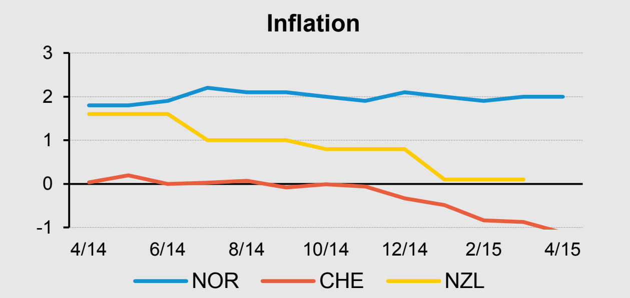
The **NBP** kept its interest rate unchanged at 1.50%. GDP growth accelerated from 3.3% in 2014 Q4 to 3.6% in 2015 Q1, fuelled by consumption, investment and an improving labour market situation. Low commodity prices and moderate nominal wage growth are creating only limited cost pressures. Inflation was -1.1% in April. Industrial producer price growth is decreasing and inflation expectations continue to be very low. The NBP expects inflation to remain negative in the coming months.

Other selected inflation-targeting countries

	Norway (NB)	Switzerland (SNB)	New Zealand (RBNZ)
Inflation target	2.5%	0–2%	2%
MP meetings (rate changes)	19 Mar (0.00) 7 May (0.00)	19 Mar (0.00)	12 Mar (0.00) 30 Apr (0.00)
Current basic rate	1.25%	from -1.25% to -0.25%[1]	3.50%
Latest inflation	2.0% (Apr 2015)	-1.1% (Apr 2015)	0.1% (2015 Q1)
Expected MP meetings	18 Jun	18 Jun	11 Jun 23 Jul
Other expected events	18 Jun: publication Monetary Policy Report	18 Jun: publication Monetary Policy Report	11 Jun: publication of Monetary Policy Statement
Expected rate movements[2]	→	→	→

[1] Chart displays centre of band; [2] direction of expected change in rates in coming quarter taken from Consensus Forecast survey or, in the case of New Zealand, from RBNZ survey.





The **NB** kept its interest rate unchanged at 1.25%. Economic growth was in line with the March projection, but wage bargaining outcomes suggest that wage growth may be lower than previously projected. Inflation is close to the NB's target. House prices continued to rise and household debt increased more than expected. Oil prices rose. The NB expects domestic economic growth to slow in the quarters ahead, still mainly due to falling activity and investment in the petroleum industry. The growth in unemployment expected in this context partially materialised. A regulation (adopted in December 2013) requiring banks to hold a countercyclical capital buffer at a set level (the current rate is 1%) will come into effect on 30 June. The regulation can be revised four times a year (for more details see here)

At its March meeting, the **SNB** left the target range for its key monetary policy rate (3M LIBOR) at between -1.25% and -0.25%. The interest rate on sight deposit account balances remained at -0.75% and the threshold was also left unchanged at CHF 10 million (a negative interest rate applies to financial institutions' balances with the SNB if they exceed this threshold). According to a statement, the SNB will remain active in the foreign exchange market, as necessary, in order to influence monetary conditions. The inflation forecast was revised downwards by 1 pp compared to the previous forecast to -1.1% for 2015 and reaches its low point in 2015 Q3 (-1.2%). The forecast for 2016 was lowered by 0.8 pp to -0.5%. According to the SNB, inflation will move into positive territory in 2017.

The **RBNZ** left its key monetary policy interest rate unchanged at 3.5%. Economic growth of 3% is being supported by growth in construction, falls in fuel prices and low interest rates. According to the RBNZ, the New Zealand dollar remains high and unsustainable in terms of New Zealand's long-term economic fundamentals. In response to a rapid rise in house prices in Auckland, and because financial sector stability is at risk, the RBNZ announced new macroeconomic policy tightening in the area of loans flowing into New Zealand's property market (see *News*).

2. NEWS

ECB plans to step up asset purchases in May and June

In a speech given at a conference on the zero lower bound on May 18, Benoît Cœuré, a member of the ECB's Executive Board, announced the ECB's plan to "moderately frontload" its asset purchases in May and June (and possibly also in September). This acceleration will enable the ECB to reduce its market presence during the lower market activity in July and August and to keep average monthly purchases at the announced level of EUR 60 billion. Cœuré also insisted that this frontloading was not a reaction to the sell-off of government bonds in the past month. In view of the fact that those non-public information were divulged only to limited audience and were not published immediately (went live only the morning after), the ECB is now reviewing its communication rules.

Riksbank redesigns its Monetary Policy Report after eight years

Sveriges Riksbank changed the structure and design of its Monetary Policy Report in order to make monetary policy and its economic effects clearer. Previously, the Riksbank had published a Monetary Policy Report in connection with three out of its six monetary policy meetings a year and a Monetary Policy Update in connection with the other three. From April onwards, the new Monetary Policy Reports will be published in connection with all six of the planned meetings. The new structure focuses more on monetary policy deliberations and on analysis of financial conditions. The report also includes explanations of how monetary conditions are likely to affect households and businesses, in form of fact boxes, charts and figures and short analysis boxes. The report still includes longer analytical articles, but focuses less on detailed data reporting. The new reports will be about one-third shorter than the previous full versions, as this was one of the requests featuring in the long-term feedback from the target readers' group. The first redesigned Monetary Policy Report was published on April 29.

Central banks of Belgium and Finland update design and functionality of their websites

The National Bank of Belgium launched a new website in April and joined several other central banks in running a responsive website design accessible from smartphones and tablets. The bank has also been migrating to a new statistical database offering new functionalities, derived from an application developed by the OECD. The Bank of Finland chose a different approach to its online presence, and to its existing website added a parallel second website dedicated to visually appealing presentation of texts and charts from its current publications. The bank will also publish additional updates and blog posts from its staff on the new site. Besides the central banks of Belgium and Finland, the Reserve Bank of India redesigned its website this year.

RBNZ introduces new macroprudential measures on lending to property investors in Auckland

In its latest Financial Stability Report the RBNZ suggests imposing targeted macroprudential measures in the Auckland region on loans to property investors with a high loan-to-value ratio (LTV, or LVR in Australia and New Zealand). The RBNZ wants to introduce these measures due to different property market trends in Auckland in comparison with the rest of the country and due to the risk of adverse effects of sharp price corrections in Auckland's property market on the whole New Zealand financial sector. House prices increased by 17% year on year in the Auckland region, compared with only 3% in the rest of the country, the median house price in the region is 60% above its 2008 level, new buyers in Auckland are becoming more indebted relative to their incomes, and property investor purchases have increased over the past year. The suggested measures restrict banks in granting loans to property investors in the Auckland region with an LTV higher than 70%, retain the existing limit for loans to owner-occupiers in the Auckland region at LTVs of over 80% (i.e. a 10% "speed limit" allowing banks a maximum 10% share of high-LTV lending in the total value of new residential mortgage lending). The existing speed limit for high LTV borrowing outside Auckland should increase from 10% to 15%. The measures, intended to come into effect in October 2015, should restrain elevated investor activity in the Auckland property market, encourage the subdued housing market conditions outside Auckland and improve the resilience of the banking system.

MNB changes its monetary policy rate

The MNB changed the definition of its benchmark policy rate. The two-week deposit facility (which is currently referred to as the policy rate) will be replaced with a three-month one. The two-week deposit will remain part of the central bank's instruments, but there will be quantitative restrictions imposed on it and it will use the auction method. The measures will be valid from 23 September 2015. The MNB's aim is to encourage government securities purchases by local banks and diminish the nation's reliance on foreign financing.

Kazakhstan and India among inflation-targeting countries

The National Bank of Kazakhstan in a May document proposed a reform of its monetary policy framework and is preparing to shift from its current managed currency float to inflation targeting by 2020. Over the next five years the bank plans to deepen the financial markets, create standard monetary policy tools based on open market operations, improve its current forecasting model and develop its communication strategy to better correspond to the standard inflation-targeting regime in developed countries. The level of the inflation target and tolerance band has not yet been specified; it will be established during the transition period by the Board of the National Bank (i.e. without government interventions). **India** formally adopted inflation targeting this February in a joint document issued by the Indian finance ministry and central bank. Monetary policy history in India is covered in the current *Spotlight*.

Olivier Blanchard to leave IMF

Olivier Blanchard announced that he will step down as IMF chief economist on 30 September. He originally joined the IMF in September 2008. The Fund has not yet picked his successor. Blanchard will join the private think-tank *The Peterson Institute for International Economics*.

3. SPOTLIGHT: INDIA'S PATH TO INFLATION TARGETING

India, the world's largest democracy and one of its fastest growing economies, joined the club of inflation-targeting countries this year. The official adoption of an inflation target of 4% with a tolerance band of ±2% marked the culmination of the Indian central bank's efforts to build an independent and trustworthy monetary policy aimed at anchoring inflation expectations at low levels. The Indian economy recovered relatively quickly from adverse external shocks in 2008 and 2013, but Indian inflation and inflation expectations remain relatively high. The switch to inflation targeting should help stabilise inflation at a time of accelerating growth in India driven by the structural reforms being phased in by the new government.

With a population of more than a billion, India is the world's largest democracy and also its third largest economy in terms of total GDP (in PPP). As early as 2001, Goldman Sachs analyst Jim O'Neill included India among the world's four largest emerging economies, for which he coined the term BRIC (Brazil, Russia, India and China). Economic growth in India averaged more than 8% between 2003 and 2008 and was associated with stable and relatively low inflation (4%–5%). The Indian government pursued a policy of fiscal consolidation, thanks to which the government deficit fell by more than 50% between 2001 and 2007 (from 5.8% to 2.5% of GDP). Economic growth slowed sharply in India following the global financial crisis, but the current data suggest that India might even outpace China in the future (although the high GDP growth rates are due in part to a change in the GDP calculation methodology introduced at the start of this year).[1,2]

The Indian central bank's monetary policy over the years

The Indian central bank (the Reserve Bank of India, RBI) celebrates its 80th birthday this year. The central bank law (originally passed in 1934) mandates the RBI to maintain price stability, to manage the circulation of currency in order to promote economic growth, and currently also to maintain financial stability. The RBI is also the manager of the national debt (talks are currently under way with the government regarding a possible transfer of this function to an independent agency). Originally a private institution, the RBI was nationalised[3] soon after India declared independence in 1947. It gradually lost its status of politically independent institution as the government worked to incorporate it into the system of central planning. The RBI's monetary policy was subsequently affected by the need to finance growing government deficits and to lend preferably to priority sectors of the economy. This inhibited lending to other areas during the period of credit aggregate targeting (until 1986). In the period of monetary aggregate targeting (which the RBI switched to in 1986), a need for automatic lending to government resulted in uncontrolled money growth and inflationary pressures. The RBI's links with government thus prevented it from meeting its objectives effectively.

The economy was liberalised in 1991. This was a necessary condition for obtaining financial assistance from the IMF after a balance of payments crisis. The government launched a fiscal consolidation policy, and commercial banks also started to buy government bonds and Treasury bills on a larger scale. The importance of the exchange rate and interest rates in monetary policy transmission increased, causing the RBI to switch at the end of the 1990s from direct monetary policy tools (reserve and liquidity requirements) to indirect market instruments (including overnight repos, i.e. operations to provide liquidity to commercial

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[1] The change in the GDP calculation methodology included a change in the reference year. The weights of industrial sectors were also changed.

[2] The Indian financial year starts on 1 April. The years given for the economic data in the text correspond to the financial year defined in this way; for example, inflation for 2012 means inflation in financial year 2012/2013 ending on 31 March 2013.

[3] Nationalisation (which the then RBI Governor protested against) was enacted in a 1948 law and took effect on 1 January 1949.

banks, reverse repos and open market operations; the marginal standing facility was introduced in October 2011 and the term repo operations were introduced in October 2013).[4]

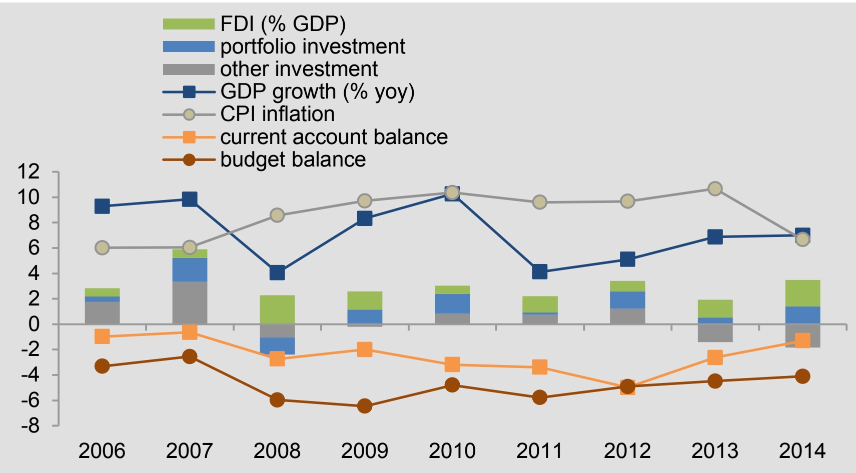
In 1998, the RBI switched from targeting monetary aggregates to formulating monetary policy by analysing and monitoring multiple indicators (monetary aggregates, loans, GDP growth, capital flows, the fiscal deficit, inflation, the exchange rate, etc.). Although this approach resulted in a decline in inflation in the initial years after its introduction, it was soon criticised for being incomprehensible and lacking a clearly defined nominal anchor. Moreover, persisting high inflation after 2009 pointed to a need to make monetary policy more effective.

The impacts of 2008 and 2013

The Indian financial markets dodged the impacts of the 2008 global financial crisis thanks to a high degree of regulation (the Indian banking sector was not involved in trading in international financial markets). However, the Indian economy was exposed to an outflow of capital, a slump in exports and a related economic slowdown. The RBI responded by easing monetary policy: it slashed interest rates and brought in measures to boost liquidity (including a lower minimum reserve requirement). The Indian government supported the economy by introducing fiscal stimulus packages, in contrast to its previous budget consolidation policy.

Economic growth in India recovered quickly after the marked 2008 slowdown, but inflation simultaneously surged (partly because of rising prices of commodities, especially oil, which accounts for almost one-third of Indian imports). Both the RBI and the government started to tighten their policies.

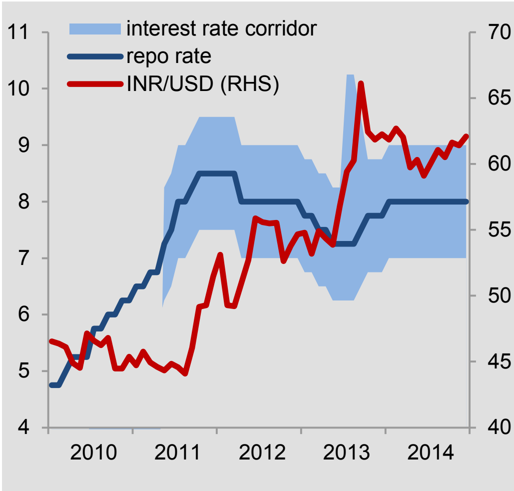
In 2012, economic growth amounted to 5%, consumer inflation was close to 10% and the current account deficit and fiscal deficit were both at 5% of GDP. It was in this condition that the Indian economy faced the Federal Reserve's May 2013 announcement of its plan to taper asset purchases. This announcement triggered a "taper tantrum" and a wave of sell-offs in financial markets across the globe in anticipation of a rise in bond yields in the USA. The "Fragile Five" of Brazil, India, Indonesia, South Africa and Turkey, characterised by double deficits (current account and public account deficits), were particularly vulnerable to capital flow volatility. In India, investment outflows caused the rupee to lose almost 20% against the dollar between May and August 2013. Asset prices plummeted and market liquidity decreased.



Source: EIU

[4] The overnight repo rate has been the key policy rate since May 2011. The reverse repo rate and the marginal standing facility rate are derived from the repo rate via a spread of ±100 bp and form the floor and ceiling respectively for daily movements in the short-term money market interest rate.

To defend the domestic currency, the RBI intervened in the forex markets between May and September 2013 and later tightened monetary policy by raising the upper boundary of the interest rate band, limiting the amount of liquidity available in overnight repos and increasing the minimum reserve requirement. In an effort to boost foreign exchange reserves, sources of external financing were sought and the RBI announced temporary unconventional measures (such as a rise in interest rate ceilings for new non-resident foreign-currency accounts), thanks to which banks managed to mobilise almost USD 35 billion, which they then swapped with the RBI. The RBI also opened US dollar liquidity swap arrangements for three state-owned oil-trading companies.



Source: Datastream, RBI

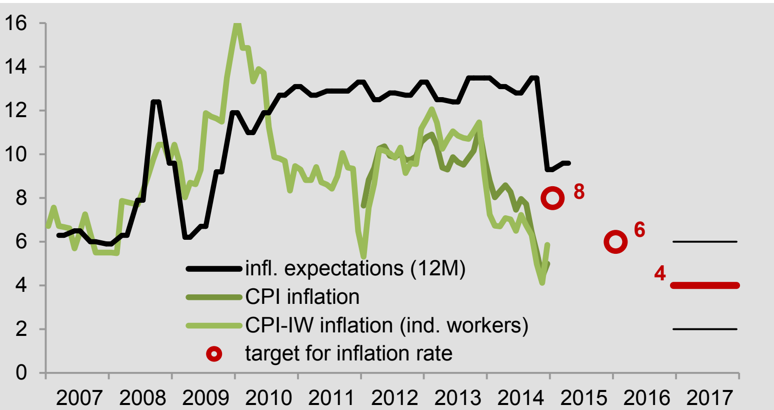
At the same time, the government introduced measures to reduce the current account deficit and support inflows of foreign capital. It imposed duties and other restrictions on imports of gold, which until then had been a major contributor to total imports, as buying gold had been a way of hedging against high domestic inflation. These actions caused gold imports to fall by almost half between 2012 and 2013 and, along with a decline in the price of gold on international markets, helped reduce the current account deficit. To boost foreign capital inflows, the government also raised the limits on foreign direct investment in selected domestic sectors (e.g. telecommunications) and on investment by foreign entities in Indian government bonds.

By November 2013, thanks to these measures, the rupee had recovered part of its losses, the balance of payments situation had improved, the outflow of portfolio investment had slowed and inflation and inflation expectations had also fallen slightly. The RBI therefore phased out its unconventional measures and the policy rate band returned to its original level.

The actual launch of tapering by the Federal Reserve in January 2014 had a much weaker effect on India than its announcement. This was due to improved external stability in India, fiscal discipline of the government and also the RBI's simpler monetary policy framework under new governor Raghuram Rajan.

The switch to inflation targeting

Raghuram Rajan, a respected former Chief Economist at the IMF, was appointed RBI Governor in September 2013. An advocate of inflation targeting (IT), he appointed a monetary policy committee in his inaugural speech. The committee presented specific recommendations for a gradual switch to IT in January 2014. The RBI adopted these recommendations and started implementing them by announcing a downward path for inflation to 8% in January 2015 (this target was hit) and on to 6% in January 2016.



Source: RBI

A key reason for introducing IT, besides bringing down persistently high and volatile inflation, was the closely related need to anchor inflation expectations at lower levels – inflation expectations in India had almost doubled from low levels in 2000–2007 to more than 10% in 2010–2014.

Inflation targeting was formally introduced in February 2015 in a document issued jointly by the Indian Ministry of Finance and the RBI. The document tasks the RBI with bringing inflation below 6% by January 2016 and sets an inflation target of 4% with a band of ±2% for financial year 2016–2017 and beyond. The inflation target is based on annual inflation as measured by a combined consumer price index.[5] Once every six months, the RBI has to publish a monetary policy report together with an inflation forecast for a horizon of 6–18 months. If it fails to meet the inflation target for three consecutive quarters, the RBI is obliged to explain the reasons for that failure to the government and to propose remedial actions. The power to set policy rates, as well as any other measures, lies with the RBI Governor (in future, the Governor is likely to chair the monetary policy committee (MPC), which will decide on monetary policy as a collective body; however, the government and the RBI have yet to agree on the staffing details; the MPC is to be established by an amendment to the RBI act this year).

Fiscally imprudent government policy might put the RBI's inflation target at risk. The current government has so far maintained the fiscal consolidation programme (the fiscal deficit was reduced from 5.7% of GDP in 2011 to 4.1% of GDP in 2014). In its end-February budget, however, it proposed a smaller-than-expected cut in the fiscal deficit and postponed the fulfilment of the target of 3% of GDP by a year (to financial year 2017–2018) owing to a need for new investment (especially in infrastructure).

Future challenges for the RBI…and for India

In addition to safeguarding financial stability and regulating and supervising the banking sector, an important task for the RBI as central bank is to broaden and deepen the banking sector's activities. This includes simplifying the entry of private and foreign banks and setting clear rules for the issuing of banking licences. State-owned banks (i.e. banks in which the state has a majority) account for almost three-quarters of the Indian banking sector. These banks have problems with low asset quality, capital adequacy and liquidity ratios. In partnership with the government, the RBI also aims to extend banking services across India (by March 2015, almost 150 million new bank accounts had been opened under a government programme launched in August 2014). However, poor financial literacy remains an issue.

Economic growth in India would benefit significantly from structural reforms. Radical reforms were expected to be implemented after the new government took office in May last year. However, a planned new nationwide tax on goods and services faces opposition in parliament, and important laws reforming the labour market and land ownership have yet to be passed as well. Nonetheless, the government has implemented reforms making it easier for foreign investors to enter some industries, the decline in oil prices has allowed it to abolish some costly subsidies, and it has generally succeeded in improving perceptions of the business environment in terms of the level of red tape and corruption. However, India still awaits fundamental reforms that will pave the way to strong economic growth.

[5] The combined consumer price index (CPI, also known as CPI-Combined or CPI-C) was constructed in 2010 as the first consumer price index covering the whole of India (i.e. both rural and urban areas). Before 2010, there had only been specific consumer indices for individual categories of the population, such as industrial workers (CPI-IW) and agricultural labourers (CPI-AL). Besides consumer prices, the RBI uses the wholesale price index (WPI) to monitor the price level.

4. SELECTED SPEECH: THE INFLATION TARGET – A BENCHMARK FOR PRICE-SETTING AND WAGE FORMATION

Henry Ohlsson, Deputy Governor of the Sveriges Riksbank, gave a speech on 16 April, at a conference organised by an industrial trade union, in which he pointed to the importance of the inflation target not only for price-setting and wage formation, but also for long-term growth.

Ohlsson began by commenting on the current situation on the Swedish labour market, which is about to enter into large-scale wage bargaining rounds. These have a long tradition in Sweden, cover a large proportion of wage agreements and traditionally repeat after three years. The wage bargaining outcome is influenced by the Swedish central bank's inflation target, which is an important anchor for inflation expectations and further shapes price-setting and wage formation. The benchmark of an inflation target of 2% was established in Sweden in 1993 after the fixed exchange rate regime was abandoned. One reason for changing to inflation targeting (IT) was high imported inflation, which was hampering growth in real purchasing power. A new monetary policy regime would remedy this problem. Ohlsson gives reasons why the target was set at 2%. These include overestimation of actual price growth by statistical measures. Higher-than-zero inflation also facilitates necessary changes in relative prices and wages and functions as a lubricant in the economy. The target, defined as low but positive inflation, furthermore leaves scope to stimulate the economy by cutting monetary policy rates in times of crises.

According to Ohlsson, it is vital to build public confidence that monetary policy will lead inflation to the target. At the moment, many economic agents assume that inflation will be around 2% in the coming period and the task for the central bank is to maintain this public persuasion. This does not mean that the Riksbank can ensure that inflation will always be 2%. Inflation can deviate from the target due to unforeseen events and/or time delays in the effects of monetary policy decisions. As Ohlsson says, the aim to bring inflation back to the target as fast as possible might stand against the aim to stabilise economic growth and employment and could imply excessive volatility. The Riksbank's ambition is therefore to return inflation to the target in a few years' time.

In his speech Ohlsson comments on the historical and current links between monetary policy, price-setting and wage formation. From the historical point of view, he compares real wage growth under the fixed exchange rate and IT regimes. Even though nominal wages grew by 9% a year on average at the time of the fixed exchange rate, growth in purchasing power was limited with a high level of inflation. Higher real wage growth came later on when inflation targeting was combined with industrial agreements. Ohlsson comments three current hot topics. The first concerns the low inflation rate, which is below the central bank's target. The drop in inflation has been driven by weak foreign and domestic demand, greater competition, uncertainty about future economic developments and in 2014 also by the slump in world energy prices. During 2010–2013 inflation was also pushed down by appreciation of the Swedish krona (depreciation in 2014 affected inflation in the opposite direction). Ohlsson's second topic is the credibility of the inflation target, which is reflected in the inflation expectations of economic agents in the longer term. Inflation expectations have been falling in recent years and are now at 1.3% two years ahead and 1.9% five years ahead. The third topic is expansionary monetary policy. During the spring, the Riksbank decided to cut repo rates further below zero, specifically to -0.1% in February and -0.25% in March. The repo rate is expected to remain at this level at least until the second half of 2016. Expansionary monetary policy was simultaneously supported by purchases of government bonds. In this context, Ohlsson stresses that, if necessary, the Riksbank is still prepared to do more to ensure that inflation rises towards the target.

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