SPEECH

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SPEAKER: Deputy Governor Göran Hjelm

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Monetary policy trade-offs and economic policy interactions in the face of supply shocks*

Today I would like to describe my view of monetary policy when supply shocks cause the prices of goods or services imported into Sweden to rise. These types of disruption were a major cause of the surge in inflation in 2022, and they are happening again now with the war in the Middle East.

The best way for monetary policy to deal with such supply shocks depends on the scale of the shocks and the current economic situation. In addition, there are two factors that are particularly important if the Riksbank is to be able to 'see through' increased inflation that is driven, for example, by temporarily high energy prices. The first is clear communication. The Riksbank needs to explain the nature of the shocks, their economic effects and why it is appropriate to allow a temporary increase in inflation. The second is that fiscal policy and wage formation do not increase the risk of a broad and persistent upturn in inflation. To avoid this, a well-functioning interaction between the Riksbank, politicians and the social partners is necessary.

This interaction worked well in the years of high inflation, when both fiscal policy and wage formation acted responsibly, which made it easier for monetary policy to give consideration to the development of the real economy. At the same time, the shocks that preceded the years of high inflation were so widespread that monetary policy needed to be tightened to ensure that the economy did not lose confidence in the inflation target. The extent of the disruption caused by the war in the Middle East depends to a large extent on how long the conflict is expected

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to last, and there is considerable uncertainty about this. Thanks to the high credibility of the inflation target and low inflation and resource utilisation at the outset, the Riksbank can await further information on how developments may affect inflation and the real economy going forward.

Communication and interaction are important tools

Developments in the 2020s have undoubtedly been turbulent. In our part of the world, we have seen immense human suffering in the wake of the pandemic and the wars in Europe and the Middle East. Moreover, there are clear signs that the previous world order, which was based on rules and diplomacy, has shifted to a power-based order that, from an economic perspective, has been characterised by US trade policy.

We have seen recurrent, large shocks to the supply of goods and services, often followed by high inflation and subdued real economic growth. There is a risk that we will see more such disruptions and also climate-related supply disruptions in the future. The task of monetary policy will then be to limit the costs to the real economy while maintaining confidence in the inflation target. A key insight is that clear communication is then particularly important to reduce the need for monetary policy tightening.

Sweden is well equipped to meet the challenges, not least thanks to the frameworks developed over almost three decades in monetary policy, fiscal policy and wage formation. I believe that the Riksbank has a particular responsibility for ensuring that the interaction between these economic policy areas functions well, not least as monetary policy is the primary tool for stabilisation policy during normal times.[1]

I will start by talking about my views on the trade-offs of monetary policy in the face of supply shocks and how fiscal policy and wage formation can affect them. Based on this description, I will go on to reflect on monetary policy choices during the years of high inflation and in the current situation when supply shocks are once again relevant. I conclude by describing how the frameworks for monetary policy, fiscal policy and wage formation form the basis for an appropriate interaction and how the Riksbank can act to strengthen it.

[1] Several authorities are involved, and many measures can be used to “stabilise the economy” in different ways. What I mean by “stabilisation policy” here is active measures to stabilise normal variations in economic activity. In the fiscal framework, the Government points out that monetary policy has the primary responsibility for this stabilisation (Government, 2025). I share this view.

'Seeing through' elevated inflation requires clarity

In addition to inflation, the Riksbank must also take into account developments in the real economy. When supply shocks drive up inflation while dampening real economic developments, that is the target variables are moving in different directions, it is appropriate to react less to rising inflation than if inflation is driven by demand.[2] This is known as 'seeing through' supply-driven inflation, in whole or in part. This is common in practice; studies from the United States show that the central bank there has historically raised the policy rate about four times more if the rise in inflation was due to demand shocks.[3]

But being able to see through high inflation requires clear communication, explaining why monetary policy is responding less to elevated inflation than normal. Otherwise, there is a risk that price-setting and wage-formation will no longer assume that the inflation target will be attained in the long run. The central bank therefore needs to explain the nature of the shocks, their expected economic impact and the monetary policy trade-offs between real and nominal stability over the forecast horizon, as well as the impact of fiscal policy and wage formation. Put differently, the central bank needs to communicate the factors that govern monetary policy, what is known as the reaction function.

It is particularly important to communicate which causes of temporarily elevated inflation are accepted and which are not. When a major supply disruption causes international prices to rise, it is reasonable for companies whose costs are clearly increasing to raise their prices. This applies both to prices that are *directly* linked to the disruption, such as fuel in the case of the Middle East war, and to prices in sectors that are clearly affected by increased costs, such as transport. The latter is an *indirect* effect.[4] The larger the disruption is, the more inflation rises via direct and indirect effects, increasing the risk of higher inflation expectations in the longer run. This can lead to *secondary effects* arising, with price increases occurring even in sectors where costs have not increased significantly or wage formation being affected. Secondary effects should not be accepted. If there is a

[2] See Hofmann et al. (2024) and Werning et al. (2025) and references therein. A smaller monetary policy response is also justified by the fact that monetary policy acts via demand and therefore cannot directly influence the cause of elevated inflation when it is supply-driven. Monetary policy may still need to act via the demand channel, to which I will return. Moreover, it is common for supply disruptions to reverse after a period of time, for example high energy prices falling back after a cold winter, which also reduces the need to tighten monetary policy.

[3] Hofmann et al. (2024).

[4] When only certain prices change in the economy, this is usually referred to as *relative price changes*, which lead to a more efficient allocation of resources and should therefore not be counteracted by the central bank; see Bank of England (2026, Box G) and references therein. These relative price changes lead to temporary increases in inflation because nominal rigidities mean that other prices rarely fall. When demand is high, it is more common for most prices to rise more than normal. This is usually referred to as a *broad* increase in inflation.

risk of this, the central bank should communicate that it is tightening monetary policy.

Monetary policy trade-offs depend on the size of the shocks and the initial state of the economy

Thus, no matter how clear the communication, a central bank cannot always see through supply-driven inflation. For example, as I will come back to, I think it was necessary to clearly tighten monetary policy in 2022–2023, as the Riksbank did, even though supply shocks were an important explanation for the high inflation.

The monetary policy response to supply shocks can be categorised somewhat simplistically on the basis of whether the magnitude of the shocks is judged to be *small*, *medium* or *large*.[5] In the case of small supply shocks that are expected to be short-lived, monetary policy should not react at all, as the effect on inflation may come too late. On the other hand, in the case of large supply shocks, monetary policy should be tightened because they risks leading to secondary effects, that is, to those setting prices and wages losing confidence in the inflation target.[6] Monetary policy tightening entails poorer real economic development but the cost risks being even higher if the Riksbank needs to raise the policy rate substantially at a later stage.[7]

In the case of a medium-sized supply shock, the central bank needs to take into account situation-specific factors when considering whether tightening is necessary.[8] A key factor is the credibility of the inflation target at the outset.[9] If credibility is high, there is a possibility of replacing monetary policy tightening with communication in which the central bank says it will accept a temporary increase in inflation that is due to price increases in sectors where costs have clearly increased. The state of the economy at the outset also matters. The higher inflation is, the more it will deviate from the target in the event of a shock, increasing the risk of secondary effects. Moreover, if resource utilisation is high, there is a greater risk that a shock will lead to broad price increases, which in turn increases the need for monetary policy tightening.[10] The starting point for the

[5] Lane (2025). By magnitude, I mean the combination of the estimated size and expected persistence of a disturbance.

[6] Moreover, the relationship between the size of shocks and their effect on inflation may be non-linear; see Bobeica et al. (2025).

[7] See Bems et al. (2021) and Romer and Romer (2024).

[8] Situation-specific factors also influence how much austerity is necessary in the event of major disruptions.

[9] See, for example, Nakamura et al. (2025) and Svensson (2010). Estimates show that if credibility had been at the level of the 1970s, the policy rate in the euro area would have needed to be raised to 8 per cent instead of 4 per cent in 2022–2023 to achieve the same outcome; see Dupraz and Marx (2023).

[10] See Adolfsen et al. (2024), Amberg et al. (2025), Comin et al. (2024) and Karadi et al. (2024). Monetary policy needs to take into account the impact of the shock on both GDP and potential GDP, the difference between which is a measure of resource utilisation. Potential GDP can be adversely affected if a shock leads to a sharp rise in production costs or if certain inputs become unavailable.

policy rate is also important, with a tightening being more necessary if monetary policy is initially clearly expansionary.

In addition to these factors, the monetary policy trade-offs can also be influenced by the behaviour of other central banks. A clear difference in expected monetary policy can affect the exchange rate to such an extent that it justifies a different monetary policy choice in Sweden than would otherwise be appropriate.

Fiscal policy and wage formation also affect the monetary policy trade-offs. Broad fiscal stimulus that leads to higher resource utilisation increases the risk that cost-driven price rises in certain sectors will spill over into a broad-based rise in inflation, which in turn increases the need for monetary policy tightening. Wage formation can be affected, albeit often with a lag, and therefore has a bearing on how long it takes the central bank to bring inflation back to target. It is particularly important to avoid secondary effects via wage formation in Sweden, as the industrial benchmark is widely disseminated and usually runs for several years. Overall, the central bank's communication with politicians and the social partners is of considerable importance. I will return to this later.

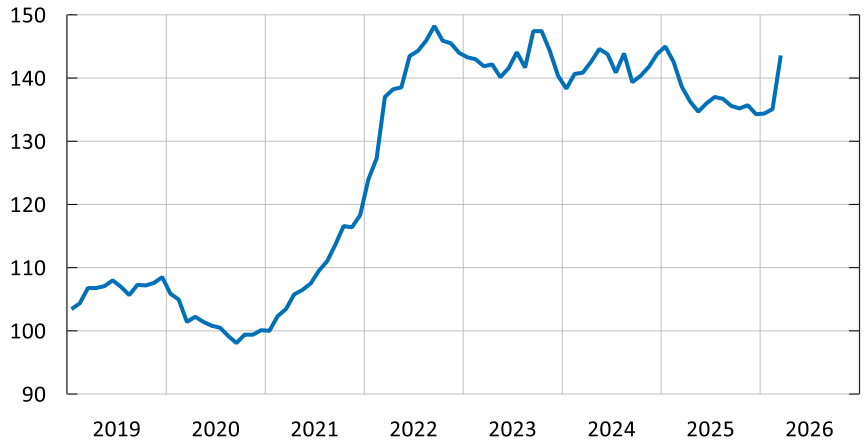
A necessary monetary tightening after the 2021–2022 supply shocks

Negative supply shocks were an important reason why inflation was so high in 2022 and 2023.[11] The scale of the international disruptions is illustrated in Figure 1, with the import price index increasing by as much as 40 per cent from mid-2021 and one year ahead. The higher cost of imports was partly due to disruptions when international production and supply chains experienced problems as the global economy reopened after the pandemic. In addition, Russia started to turn off the gas tap, which contributed to rising gas and electricity prices in Europe, including Sweden. Russia's full-scale invasion of Ukraine in February 2022 then sent gas and electricity prices soaring, while oil and food prices rose by tens of per cent.

[11] Demand shocks also contributed, not least via the pent-up demand that materialised as the pandemic began to loosen its grip in the second half of 2021, see Durakovic et al. (2025) for an analysis of Sweden and Hernández de Cos (2025) for an analysis of the euro area.

Figure 1. Import price index

Index, January 2021 =100



Note. The import price index measures price trends on products imported to Sweden. Latest outcome refers to March 2026.

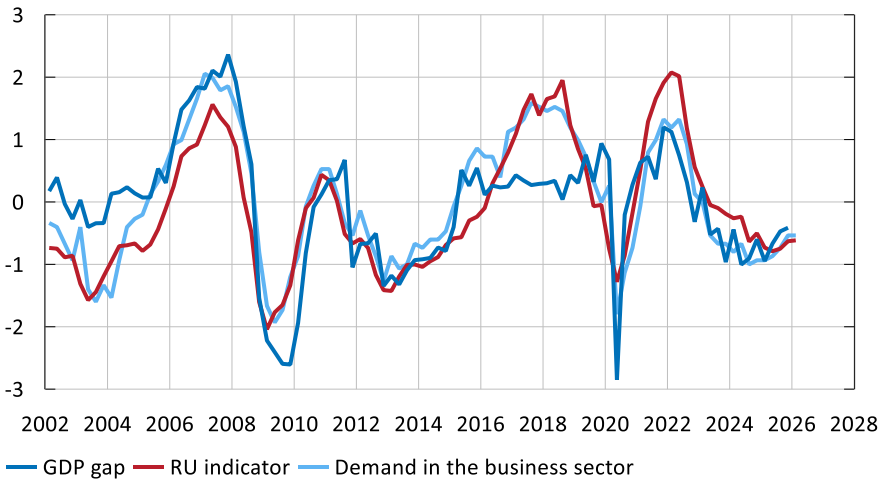
Source: Statistics Sweden.

The higher inflation in autumn 2021 was mainly due to rising energy prices. When Russia then invaded Ukraine, several of the factors I described above pointed to a clear tightening; the scale of the disruptions increased rapidly (Figure 1), resource utilisation was high (Figure 2), underlying inflation was elevated, and the policy rate was very low (Figure 3). In addition, the krona weakened significantly in 2022. The Riksbank started raising the policy rate at a rapid pace in April 2022, from 0 per cent to 4 per cent in September 2023. The tightening helped ensure that overall price increases in the business sector did not on average overstep the significant cost increases caused by the shocks.[12]

[12] National Institute of Economic Research (2023). See table 15 and Annex 2 of the study for the evolution of costs and prices in different sub-sectors between Q2 2022 and Q2 2023. For international evidence, see Dedola et al. (2024) and Gagliardone et al. (2025).

Figure 2. Indicators of resource utilisation

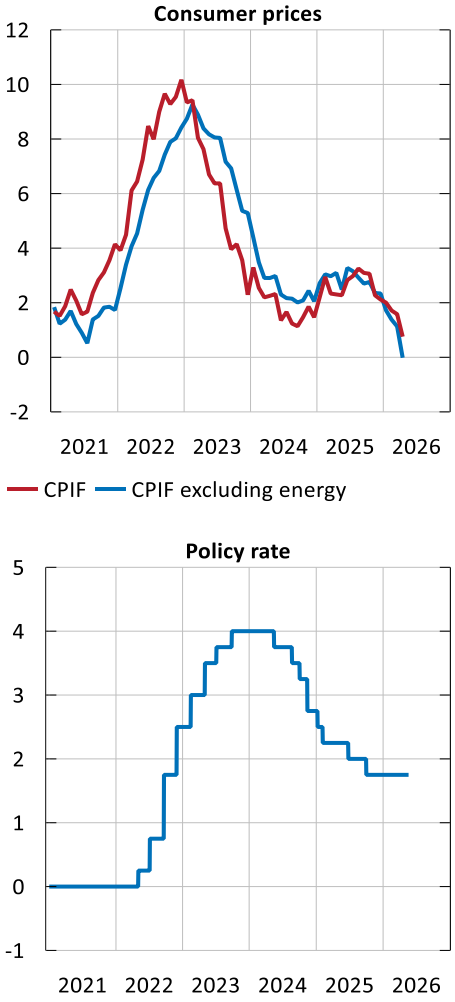
Standard deviation



Note. Seasonally adjusted data. The GDP gap refers to the deviation of GDP from the Riksbank's assessed trend. The RU indicator is a statistical measure of resource utilisation. The series are standardised so that the mean value is 0 and the standard deviation is 1.

Sources: National Institute of Economic Research, Statistics Sweden and the Riksbank.

Figure 3. Consumer prices and the policy rate
Annual percentage change (left) and per cent (right)



Sources: Statistics Sweden and the Riksbank.

I share the Riksbank's assessment that it was appropriate to substantially tighten monetary policy from spring 2022. This helped to prevent secondary effects in the form of price increases beyond what the substantial cost increases justified. At the same time, it was reasonable for monetary policy not to prevent the significant cost increases entailing relative price increases that were to a large extent passed on to consumers. This would have required even larger interest rate hikes, resulting in significantly weaker real economic growth. In addition, the Riksbank communicated that broad fiscal policy stimulus could mean that monetary policy would need to be tightened even more and that it was important that the inflation target, despite elevated inflation, should be the benchmark for wage formation. The message to the social partners was that the Riksbank would

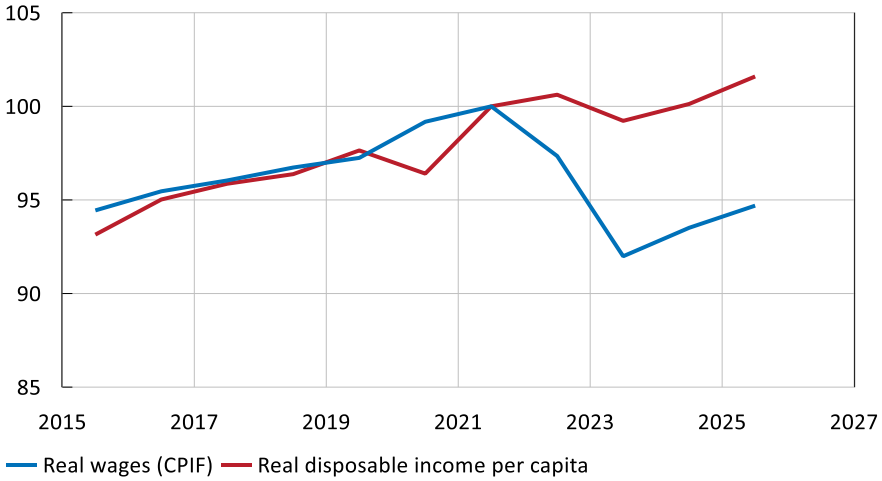
take responsibility for ensuring that deviations from the inflation target would not be prolonged.[13]

A predictable and responsible fiscal policy and wage formation made things easier for monetary policy

In the budget bills for 2023, 2024 and 2025, a prominent message was that fiscal policy should be restrained, thereby making it easier for monetary policy to combat inflation.[14] The fiscal stance, measured as the change in structural net lending, was in principle neutral during these years. At the same time, households were supported, with disposable income clearly outperforming real wages (see Figure 4).[15] This may have contributed to wage formation being more restrained than might otherwise have been the case.[16]

Figure 4. Real wages and real disposable income per capita

Index, 2021 = 100



Note. Real disposable income per capita is calculated as the ratio between disposable income per capita and the deflator of household consumption expenditure, which usually increases at the same rate as the CPIF. Real wages are calculated as the ratio between the nominal wage level and the CPIF. Annual data.

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

For wage formation, I have previously likened supply shocks to throwing a jigsaw puzzle into the air where the pieces – inflation, relative prices, real wages, wage share, terms of trade – fall down in a jumble.[17] One needs to allow the picture to become clear before analysing the impact. I also think that the social partners

[13] See, for example, Sveriges Riksbank (2022a, b).

[14] See, for example, the Fiscal Plan in the Budget Bill for 2023 (Government, 2022).

[15] Fiscal Policy Council (2026), Chapter 3.

[16] The Riksbank emphasised this channel, see for example Sveriges Riksbank (2022a).

[17] Hjelm (2025).

acted thoughtfully in these turbulent times. The rate of increase in the 2023 and 2025 agreements averaged at 3.4 per cent a year, compared with a previous average of 2.1 per cent.[18] The fact that the agreed wage increases in 2023 and 2025 were higher than in the 2010s could be due to the comparatively high profitability in the industry, especially ahead of the 2023 agreement.[19] But it could also be due to higher inflation expectations – the parties' two-year inflation expectations were 0.8 percentage points higher on average prior to the 2023 and 2025 agreements.[20] This indicates the importance of the parties expecting inflation to be close to the target in the long run.

Labour costs, which include wage drift and non-wage costs, are expected to increase by on average 3.9 per cent a year in 2023–2026[21], compared with an average of 2.9 per cent a year in 2010–2022. This can be compared with the rate of increase in labour costs of around 3.5 per cent, which according to the National Institute of Economic Research is compatible with the inflation target in the longer term.[22]

My overall assessment is that the inflation target was an important guide for wage formation during these years. Together with the predictability of the two-year agreements in 2023 and 2025, this made it easier for monetary policy to balance fighting inflation with giving consideration to developments in the real economy.

The Riksbank can await for further information on the effects of the war on the economy

At the monetary policy meeting on 6 May, I assessed that inflation risked rising because of the supply disruptions caused by the war in the Middle East up to that point. Since the outbreak of the war, oil and several other commodity prices have risen, although they are expected to fall again this year (see Figure 5). In March, the import price index rose by as much as 6 per cent, with the increase dominated by higher fuel prices (see Figure 1).

[18] The average of 2.1 per cent refers to agreed labour costs for the years 2010, 2013, 2016, 2017 and 2020, and is based on the National Accounts.

[19] For example, according to the National Institute of Economic Research's business tendency survey, the profitability assessment in industry was higher than normal in 2021–2023.

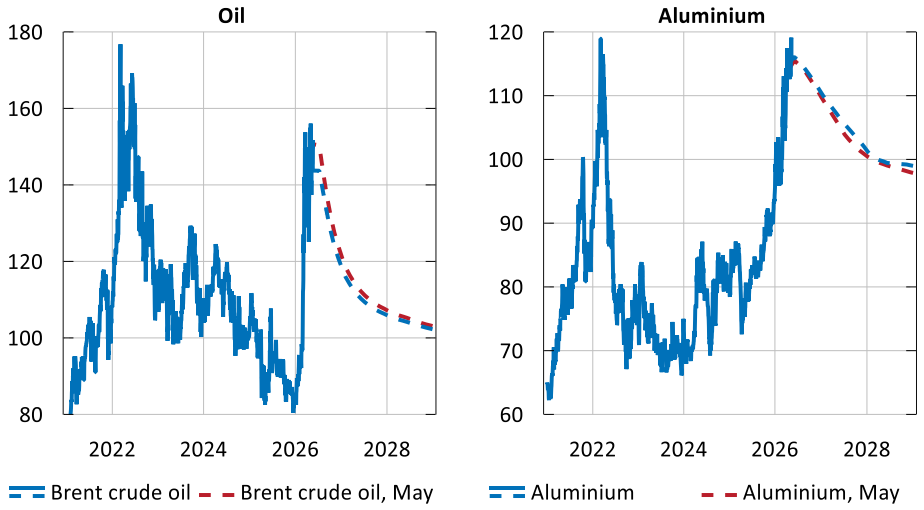
[20] Two-year inflation expectations averaged 1.6 per cent in the 2010, 2013, 2016, 2017 and 2020 agreements, while in the 2023 and 2025 agreements they averaged 2.4 per cent. The average is based on employers' and employees' expectations (all surveys refer to March except for 2020, which refers to September). See the Prospera and Origo websites.

[21] Refers to April 2023–March 2027 and includes the Riksbank's forecast from March 2026.

[22] See National Institute of Economic Research (2024).

Figure 5. The price on oil and aluminium

Index, 27 February 2026 = 100



Note. Solid lines show outcomes as of May 20 while the dashed blue lines refer to futures prices on the same day. Red dashed lines refer to futures prices at the time of the monetary policy meeting in May.

Sources: Intercontinental Exchange and London Metal Exchange.

I favoured an unchanged policy rate on the basis of the three conditions that I have highlighted in this speech: the size of the shocks, the credibility of the inflation target and situation-specific factors. Taken together, they led me to believe that the Riksbank should wait and see how the war develops and what effects it has on the economy.

It is of course difficult to estimate the extent of the disruption while the war is still ongoing. As commodity prices were expected to fall back, I interpreted the overall shocks in early May as medium-sized. Of course, a war can have very bad outcomes. However, I considered that, given the high credibility of the inflation target, we did not need to factor in such outcomes beyond the way they are expressed in forward pricing. Thanks to this and favourable situational factors, the Riksbank was, in my view, also able to see through the risk that inflation could be slightly elevated. Several factors are in principle the reverse of what they were when inflation picked up in 2022 – we now have low core inflation (Figure 3), low resource utilisation (Figure 2) and relatively normal interest rates (Figure 3).[23] In the monetary policy decision, I also emphasised that the responsible development of fiscal policy and wage formation when inflation was high in 2022–2023 reduces

[23] The policy rate is currently 1.75 per cent and is thus within the Riksbank's assessed interval of 1.5-3 per cent for the neutral interest rate in the longer term. See Sveriges Riksbank (2024).

the risk that the supply shocks we are now seeing will have broad and lasting effects on inflation.[24]

Interaction is good at present but can be strengthened

As I have said, I believe that the interaction between monetary policy, fiscal policy and wage formation worked well during the years of high inflation. This reduced the risk that the rise in inflation would be broad and lasting, which helped monetary policy to take greater account of developments in the real economy. I will conclude this speech by describing how the economic policy framework contributes to good interaction and how the Riksbank can further strengthen it in the future.

Fiscal policy has become more predictable

In the updated fiscal framework, the stabilisation role of fiscal policy is clear.[25] First and foremost, it is established that monetary policy in normal times is the main tool for stabilisation policy. In addition, two situations are highlighted where fiscal policy may be particularly needed to support monetary policy. The first is when inflation is low and the policy rate reaches a lower bound, as it did in the second half of the 2010s. It is pointed out that fiscal policy may need to play a greater role, as monetary policy may find it difficult to stabilise the economy in such situations. This may reduce the likelihood that the Riksbank will need to take unconventional measures when the interest rate cannot be lowered further. The second situation is in the case of supply shocks, where the framework emphasises that fiscal policy should not make it more difficult for monetary policy to combat inflation.

These clarifications make fiscal policy more predictable, reducing uncertainty for monetary policy. It should also be noted that the Government publishes its own forecasts for the policy rate and wages, i.e. how the Riksbank and the social partners are expected to act, which contributes to increased understanding and facilitates interaction.

The social partners seem to use the inflation target as a base

When it comes to wage formation, the Industrial Agreement forms a central part of the framework. It requires the parties to take into account, for instance, the impact of wage formation on inflation, employment and competitiveness.[26] The

[24] In the minutes from the Executive Board monetary policy meeting, I describe which indicators and incoming data I particularly intend to consider ahead of future monetary policy decisions, see Sveriges Riksbank (2026).

[25] Government (2025). The framework is based on the proposals of a parliamentary inquiry, SOU 2024:76.

[26] The Industrial Agreement was established in 1997, and the current agreement was updated in 2016, see Industry Council (2016).

Industrial Agreement is signed between a limited number of parties while affecting the development of the entire labour market. This facilitates the Riksbank's communication with the social partners. The agreements are also often multi-year, which reduces uncertainty for monetary policy.

The fact that wage formation takes the inflation target as its starting point is crucial for the inflation targeting regime we have today to work. Although the role of the inflation target in wage formation is not stated in the Industrial Agreement, I believe that the social partners in practice take the inflation target as a starting point in their negotiations. This is particularly important when, as in the 2010s, inflation is clearly below target and when, as in 2022–2023, it is clearly above.

The Riksbank contributes through clear communication

As I emphasised in my introduction, I believe that the Riksbank has a particular responsibility for the interaction between economic agents. Above all, it is about clear communication. The Riksbank is recognised as a transparent central bank[27] which forms the basis for good communication. By publishing forecasts of the policy rate, public finances and wage developments, the Riksbank makes it clear what the assessments are based on. Furthermore, the Riksbank regularly presents alternative scenarios that describe how monetary policy could change if economic developments are different. In addition, as in the years of high inflation, the Riksbank can communicate in particular how fiscal policy and wage formation affect the monetary policy trade-offs.

But the Riksbank has great analytical capacity and I think we can do further work in several areas. For example, I believe that we with the aid of structural models, such as MAJA, we can more regularly describe the type of shocks that are currently important drivers of development, including how they affect the conditions for monetary policy, fiscal policy and wage formation. I also believe that we can better understand how disruptions affect costs for companies at different stages of production and consumption. In this area, several central banks use what are known as input-output models and I believe such an approach would increase the understanding of, and the Riksbank's communication about, the dynamics of inflation. Finally, I think that the work on alternative scenarios and sensitivity analyses can continue to be developed, for instance by describing the trade-offs that the Riksbank makes between nominal and real stability and how they are affected by fiscal policy and wage formation.

[27] See Breman and Seim (2025) and references therein.

Concluding comments

It is a recurring mantra that central banks should act to ‘maintain credibility while limiting the costs to the real economy’ of supply-driven inflation. The Riksbank is well placed to take the real economy into account, thanks to the credibility that the Riksbank has created for the inflation target. But it also depends on frameworks that make fiscal policy and wage formation more predictable. The responsible behaviour we saw from both politicians and social partners when inflation was high reduces my concern that supply-driven price increases will lead to broad and sustained higher inflation in the future.

Clear communication is needed to see through temporary increases in supply-driven inflation. The drivers of inflation need to be explained and the need for interaction with fiscal policy and wage formation clarified. I believe that the Riksbank is at the forefront in this area but that further development is needed.

Overall, this gives the Riksbank greater room for manoeuvre to achieve the best possible economic outcome. However, this is freedom under responsibility. When large supply shocks risk leading to a broad and persistent deviation from the inflation target, monetary policy should be clearly tightened. Maintaining permanently low and stable inflation is the Riksbank's overriding objective in all situations and is a cornerstone of good economic development.

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