Monetary policy minutes

September 2022

S V E R I G E S R I K S B A N K

Summary

Inflation is too high. It is undermining households' purchasing power and making it more difficult for households and companies to plan their finances. It is very important that monetary policy continues to act for inflation to fall back and stabilise at the target of 2 per cent within a reasonable time perspective. At its monetary policy meeting on 19 September, the Executive Board of the Riksbank decided to raise the policy rate by 1 percentage point to 1.75 per cent.

The members concluded that inflation has continued to rise rapidly, both in Sweden and abroad, and that central banks around the world have tightened their monetary policy. They noted that Swedish inflation had become higher than in the Riksbank's forecast and that it was expected to continue rising for a further period.

The members said that the long-term inflation expectations had, at the same time, been relatively stable, and emphasised that it is important to safeguard confidence in the inflation target. Given that inflation has become higher than expected and that price increases are spreading broadly throughout the economy, the members were agreed that monetary policy needs to be tightened more than they assessed in June, and they supported the decision to raise the policy rate by 1 percentage point, from 0.75 to 1.75 per cent. Interest expenditure will increase for households and companies. However, the members considered that this cost must be weighed against the long-term gains, both for individual households and for the economy as a whole, of inflation falling back and becoming low and stable again.

All members supported the forecast for the policy rate, which entails continued raises over the coming six months. They were also careful to emphasise that there is considerable uncertainty surrounding the development of inflation, but at the same time agreed that monetary policy will be adapted as necessary to return inflation to the target.

MONETARY POLICY MINUTES
Executive Board, No.4

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 787 00 00
Fax +46 8 21 05 31
registratorn@riksbank.se
www.riksbank.se

DATE: 19 September 2022

TIME: 09:00

PRESENT:
Stefan Ingves, Chair
Anna Breman
Martin Flodén
Per Jansson
Henry Ohlsson

Susanne Eberstein, Chair, General Council of the Riksbank
Michael Lundholm, Deputy Chair, General Council, remotely

Robin Ahlén (§ 1-3a)
Johan Almenberg
Charlotta Edler
Mattias Erlandsson
Eva Forsell
Anders Gånge, remotely
Jesper Hansson
Marie Hesselman
Christina Håkanson
Iida Häkkinen Skans
Jens Iversen
Pernilla Meyersson
Ann-Leena Mikiver
Olof Sandstedt, remotely
Åsa Olli Segendorf
Maria Sjödin

It was noted that Christina Håkanson and Iida Häkkinen Skans would prepare the draft monetary policy minutes.

§3a. Economic developments

Market developments since the last monetary policy meeting

Robin Ahlén from the Markets Department began by presenting the latest developments on financial markets. There has been considerable focus in the financial markets on the development of inflation and how central banks will respond to it, on the energy crisis in Europe and the risk of weaker economic activity or a recession. Expectations of monetary policy have varied somewhat, but overall expectations of the policy rates have risen globally since the previous monetary policy meeting. At the beginning of the summer, interest rates fell as a result of concern over weaker global economic outlook. Recently, however, interest rates and policy rate expectations have risen, as inflation has become higher than expected and central banks around the world have continued to raise their policy rates in large increments and signalled that they will continue tightening policy until inflation is under control. The market is expecting large interest rate increases in the coming year.

The ECB has raised its policy rate twice since the previous monetary policy meeting, by 0.5 percentage points in July and 0.75 percentage point in September. They are also planning to continue raising the policy rate going forward and the market is discounting around 1.3 percentage points higher policy rates at the end of the year. The ECB has also introduced a new instrument, Transmission Protection Instrument (TPI), to support the monetary policy transmission in the euro area and phase out the two-layer system. The Federal Reserve raised its policy rate by 0.75 percentage points in July and market pricing indicates further policy rate increases up to the end of the year, around 2 percentage points. The central bank has been clear that no interest rate cut is imminent, but rather that the higher policy rate level may be maintained for a longer period of time. The Bank of England raised its policy rate by 0.5 percentage points in August and is expected to raise it further. Within the coming weeks, the Bank of England is also planning to start selling off its holdings of corporate and government bonds.

Prices of natural gas and electricity rose substantially in Europe at the beginning of the summer, partly due to concern that Russia would turn off the gas taps, which created a number of questions as to how Europe will manage the winter and how it will affect economic developments. However, prices have fallen from the highest levels after the EU proposed, and individual countries have both adopted and announced, a number of measures to tackle this development. In addition, the gas storage facilities have been refilled faster than expected in Europe. The oil price has fallen, despite OPEC+ having decided to reduce oil production somewhat due to reduced expected demand from China, as a result of continued shut-downs related to Covid-19.

Market-based measures of long-term inflation expectations in the United States and Europe have been relatively stable, just over 2 per cent, since the previous monetary policy meeting. The general risk climate has recently followed expectations of inflation and central banks. All in all, however, stock exchanges are relatively unchanged since the previous monetary policy meeting and the differentials for corporate bonds with good credit ratings in relation to government bonds have remained relatively stable, or even declined somewhat, in both the United States and Europe.

The US dollar has shown a broad rising trend over the year and has continued to appreciate since the previous Monetary Policy Report against both the euro and the krona. The stronger dollar is explained by unease that has prevailed on the financial markets and the fact that the Fed is expected to tighten at a faster pace, while the euro is weighed down by the energy crisis. The Swedish krona is greatly affected by the general sentiment on the markets and, in trade-weighted (KIX) terms, the krona is somewhat weaker than it was at the time of the previous monetary policy decision.

Prior to today's monetary policy meeting, analysts are expecting that the Riksbank will raise the policy rate by 0.75 percentage points to 1.5 per cent and that the policy rate will be 2.25–2.50 per cent in February next year. Market pricing of the policy rate has risen in line with the international developments in interest rates and indicates more and faster increases than analysts are expecting and in relation to the Riksbank's forecast in June. Market pricing indicates a policy rate of around 3.5 per cent next year. Analysts often highlight the fact that the Swedish economy is sensitive to interest rates as a reason why they are expecting fewer increases than are indicated by market pricing. Most analysts believe that asset purchases will be reduced or ceased in the fourth quarter.

The situation in the banking sector and financial stability

Olof Sandstedt, Head of the Financial Stability Department, described the situation in the housing market and the funding situation for companies and banks. Housing prices are continuing to fall. The annual rate of increase has slowed down and, in July, housing prices according to HOX had declined by 2.6 per cent compared with one year ago, of which single-family dwellings by 2.4 per cent and tenant-owned apartments by 2.9 per cent. Since prices peaked in March, housing prices (HOX) have fallen by a good 8 per cent (not seasonally-adjusted). In seasonally-adjusted terms, prices declined by almost 6 per cent during the same period.

Companies, particularly those in the manufacturing industry, are still meeting major cost increases measured in terms of the producer price index, while the rate of increase in the service sector is in line with the CPI. So far, companies on the whole have good earnings, as they have succeeded in passing on their costs increases to consumers. Debt growth among companies is high, although it declined somewhat during the summer months. Funding costs are still high on the corporate bond market, and the cost of bank loans has begun to increase. However, the number of bankruptcies remains at roughly the same level as in the years prior to the pandemic.

In the commercial property sector, property values have risen so far this year. The growth rate in property companies' loans remains at the same level as last spring – around 10 per cent as an annual rate. Compared with before, however, an increasing number are turning to the banks for loans, as funding costs on the capital market are still much higher. The cost of bank loans has begun to rise, but is far from the increase on the capital market. As an example, corporate bond yields in several cases exceed the direct yield on certain types of property. Higher funding costs will lead to higher direct yield requirements and thereby lower property values. The fact that property companies' rental income is in many cases written up by the CPI can, to some extent, compensate for the higher financing costs.

Yield spreads on Swedish covered bonds have been volatile over the summer, but are at roughly the same level as at the monetary policy decision in June. The large increases in risk premiums that we saw at the beginning of the year have stabilised, despite housing prices continuing to fall. With regard to interbank rates, STIBOR, which reflects interest rates on short interbank loans in Sweden, has risen to 1.6 per cent for the 3-month rate. USD LIBOR, which reflects loans between banks in US dollars without collateral, has continued to rise and the 3-month rate is now at 3.3 per cent. One can also clearly see that the market is pricing in future rate increases from the Riksbank.

SWESTR, which is a transaction-based overnight reference rate, has also risen since the most recent interest rate decision and is now at 0.7 per cent. Interest rates are clearly following the increases made by the central banks.

Deposit rates are generally still just over zero per cent (0.1-0.2 per cent) for transaction accounts, which comprise 80-90 per cent of the deposits. However, fixed rates are positive and amount to just over 2 per cent for deposits fixed at more than two years. Mortgage rates have increased in recent months, especially on longer maturities, but variable rates have also begun rising.

The current monetary policy drafting process – new data and forecasts

Åsa Olli Segendorf, Deputy Head of the Monetary Policy Department, described the current assessment of macroeconomic developments since the monetary policy meeting on 29 June and the proposal for a monetary policy decision. The background material for today's decision has been discussed on five occasions, at the introductory drafting meeting on 23 August, the monetary policy group meetings on 5 and 6 September, the reconciliation meeting on 8 September and the Executive Board meeting on 13 September, where the draft Monetary Policy Report was also discussed and tabled.

The preparations for today's meeting have primarily focused on the development of inflation in Sweden and abroad. The incoming statistics and other information have been analysed for signs that inflation is spreading further via higher inflation expectations and wage increases. The Executive Board members have also pointed out during the drafting process the uncertainty regarding the development of inflation in both the short and long term.

Another central question has been how the energy markets in Europe have been affected by the reduction in gas deliveries from Russia and how this in turn has affected inflation in Sweden via the European electricity market. The price of natural gas rose substantially at the beginning of the summer and, because of the way pricing on the European electricity market functions, this has led to rising electricity prices in Sweden, too.

Another central issue has been how future global economic activity is affected by high inflation and tighter monetary policy. An important question for Sweden is how interest-rate sensitivity among households and companies affects the monetary policy transmission. The Riksbank's analyses, which are described in an article in the draft Monetary Policy Report, show that the increased indebtedness among households has led to monetary policy now having a greater impact on demand in the economy.

The assessment of economic developments in Sweden and abroad is described in the draft report and Ms Olli Segendorf briefly summarised the most important conclusions. She observed that with regard to international developments, inflation is high and continued to rise rapidly over the summer in many countries. The high level of inflation is due to supply shocks that have for some time affected the global economy, to demand being high after the pandemic and to the war in Ukraine. In August, inflation in both Sweden and the euro area rose, while it was somewhat restrained in the United States and United Kingdom. Because of the sharp rise in inflation, many central banks are now tightening their monetary policy. Compared with earlier periods of interest rate increases, the increases are now being made at a rapid pace. With the tighter monetary policy, inflation is expected to fall next year. Demand will slow down going forward, at the same time as supply disruptions gradually wane. In 2024 and 2025, inflation in Sweden and abroad is expected to be roughly in line with central banks' inflation targets.

Since the June Monetary Policy Report, Statistics Sweden has reported three monthly outcomes for inflation. Price developments were strong in all of these months and higher than the forecast in June. Expectations of inflation in the longer run appear relatively well in line with the target. However, there has been a rapid upturn in inflation recently, and there is thus considerable uncertainty over developments going forward. Although electricity prices have contributed substantially to the rise in inflation, prices are rising on a broad scale. Detailed analyses of the inflation outcomes and the reasons behind them have been important to the assessment of both the development of inflation in the short term and of how persistent the higher inflation might be. The analyses are described in an article in the draft Monetary Policy Report.

Tighter monetary policy, less expansionary financial conditions and higher inflation are expected to slow down global growth. Forward-looking indicators point to growth slowing down now, for instance, consumer confidence has fallen to historically low levels in many countries. The major disruptions on the European energy market, tighter monetary policy and weaker international demand will cool down the Swedish economy going forward. GDP growth is expected to increase at a slower pace than the assessment in June and to become slightly negative next year. The rising prices and interest rates will become tangible. However, the starting situation on the labour market is good. Demand for labour is very high at present and it is difficult to get hold of labour. However, next year unemployment will rise and the employment rate will fall somewhat from a high level.

The forecasts in the draft Monetary Policy Report are based on the monetary policy that is expected to gain a majority at today's meeting. In brief, this means that to bring down inflation and safeguard the inflation target, the policy rate will be raised by 1 percentage point to 1.75 per cent at today's meeting and that there will be further increases in the coming six months.

Further, the Riksbank's asset purchases will continue in accordance with the monetary policy decision in June. The purchases are expected to cease at the end of the year.

§3b. The economic situation and monetary policy

First Deputy Governor Anna Breman:

I support the proposal to raise the policy rate from 0.75 to 1.75 per cent, the forecast and policy rate path in the draft Monetary Policy Report. I also support the continued reduction of the asset holdings in line with earlier decisions.

Today's decision means that during 2022 we will have raised the policy rate by 1.75 percentage points and at the same time tapered our asset holdings. Despite this, it is likely that inflation will continue to rise in the near term. Inflation will not fall until next year, reflecting that it takes time for economic agents to adjust to the new level of interest rates. This is why I support front-loaded rate hikes and a path that then indicates further raises but in smaller steps.

CPIF inflation was 9 per cent in the latest outcome for August, at the same time as indicators show that economic activity is now slowing down fast in Sweden. Weaker short-term growth when interest rates rise must be weighed against the long-term economic gains following from a rapid return to low and stable inflation; that the inflation target acts as an anchor for price- and wage setting. This enables real wage increases for households and internationally competitive companies.

It is important that we are clear about the risks involved in acting either too little or too much. Insufficient rate rises could lead to a price-and wage spiral and even higher rate rises being required later on. Too much tightening would instead risk leading to a deep and prolonged recession, creating difficulties in maintaining the inflation target in the medium to long run. To attain low and stable inflation, monetary policy should decrease, not amplify, fluctuations in economic activity.

I would like to emphasise three aspects that are important to the monetary policy deliberations at today's meeting: the risks to the inflation outlook, interest-rate sensitivity in the Swedish economy and the impact of rate hikes on the Swedish economy and inflation.

Allow me to start by going over my view of inflation going forward. At all the monetary policy meetings this year – February, April and June – I have emphasised that inflation risked rising above forecast. Today's meeting is the first in 2022 at which I consider that risks to the outlook are more balanced. It is still very possible that inflation will be even higher than currently forecast. Electricity prices may become even higher than in the forecast, global inflationary pressures may rise and there is a risk of hysteresis in domestic inflation. We may have to raise the policy rate higher than the forecast indicates.

However, for the first time in a long while, inflation may also become lower than in the forecast. Firstly, there are uncertainties over how a possible electricity price compensation may affect inflation. Many countries already have some form of electricity price compensation or regulated pricing that prevents high market prices for electricity from impacting fully on households. The Riksbank's CPIF forecast does not include any measures to reduce households' electricity costs. Introducing such measures could lead to lower inflation measured as both the CPIF and the CPIF excluding energy (through lower indirect effects of electricity prices on other price categories).[1]

Inflation may also be lower than forecast because supply shocks after the pandemic are waning. Freight costs and commodity prices, including global food prices, have started to fall (see Figure 45 in the draft Monetary Policy Report) and this could have a greater impact than we have reckoned with in our forecast. In addition, many central banks are tightening monetary policy, which is starting to have an effect on demand. We may thus need to raise the policy rate by less than the interest rate path indicates.

This leads me to interest-rate sensitivity in the Swedish economy. My assessment is that the current rate rises are clearly contractionary and will be effective in returning inflation to the target. We know that Sweden is a country in which rate rises will have a strong and rapid impact on the economy. This is a consequence of both household and corporate indebtedness being high and of short duration – both from a historical perspective and in international comparisons. I warmly recommend the well-written article, which carefully reports statistics and analyses their effects.[2]

A policy rate of 1.75 per cent may seem like a very low interest rate in relation to inflation of 9 per cent. However, reaching conclusions on the basis of levels like this is far too simplistic an analysis. The important thing is how much rate rises, combined with tapering of the asset holdings, affect economic activity and inflation. This means we have to analyse the effects on household and corporate interest expenditure, e.g. the cash flow effect. A policy rate in line with the forecast, just over 2 per cent in 2023, would lead to a sharp increase in expenditure for

[1] For more details, see the article "What effect can measures to dampen the electricity price have on inflation?" in the draft Monetary Policy Report.
[2] See the article "Higher sensitivity to interest rates in the Swedish economy" in the draft Monetary Policy Report.

households, corresponding to the interest expenditures they last had in the mid-1990s, when the policy rate was 8 per cent.[3]

In addition, it is households with a high propensity to consume that will be impacted most by both rising interest rates and high inflation.[4] The rise in inflation is broad, but the goods and services increasing most of all in price are those that households cannot choose not to consume: energy and food.[5] Households are thus cutting back on other types of consumption. For example, retail trade had already started to slow down in the summer. Companies are also highly indebted but there are large variations between different companies and sectors. The highly interest-rate sensitive real estate sector will probably cut back on investment in the period ahead. Small and medium-sized enterprises in the domestic service sector, which is important for job growth, may also be hit hard by rising interest costs, at the same time as many households are cutting back on non-essential consumption.

Two important conclusions in the analysis in the draft Monetary Policy Report are that (i) models based on historical data will underestimate the impact of policy rate rises on the Swedish economy and (ii) the policy rate does not need to be raised as much to have the same tightening effect as before. As mentioned, a policy rate of 2 per cent today corresponds to one of 8 per cent in the mid-1990s in terms of household interest expenditures. In addition, unlike in the mid-1990s, we have well-anchored long-term inflation expectations and a better functioning wage formation model.[6] Taken together, this means that my assessment is that rising interest rates will have a large and rapid impact on the Swedish economy and on inflation.

To conclude, I would like to comment on the forecast for the policy rate. It indicates continued rate rises at the end of this year and start of 2023, albeit in smaller steps than the one decided at this meeting. This means that we are planning to slow down our interest rate increases at coming meetings, even though inflation is still expected to be rising. This will require us to keep a cool head. And this is why I stress that the pass through of monetary policy on economic activity takes time. Rate hikes are also taking place in larger steps than in previous rate hikes and, since the pandemic started, we have been in a period of unusually large and rapid movements in GDP and

[3] See Figure 52 in the draft Monetary Policy Report.
[4] See the article "Higher sensitivity to interest rates in the Swedish economy" in the draft Monetary Policy Report and speech by A. Breman, "Inflation and monetary policy in the shadow of war", 23 March 2022, Sveriges Riksbank.
[5] See Figure 36 in the draft Monetary Policy Report.
[6] See the article "The economic-policy framework facilitates a return to the target" in the draft Monetary Policy Report and speech by A, Breman "From 500 percent to -0.5 percent – and then what?", 31 August 2022, Sveriges Riksbank.

inflation. Why does this matter? Let me make a quick comparison to the monetary policy considerations we had in conjunction with the pandemic.

Rapid and comprehensive policy measures at the start of the Covid-19 crisis in March 2020 prevented a financial crisis, created the conditions for a strong recovery and safeguarded price stability. However, in November 2020, I entered a reservation against the extent of the increase in asset purchases. The purchases already decided upon would affect the economy for a long time to come and further major asset purchases risked fuelling negative side effects. Similarly, I now advocate a monetary policy strategy that considers that it will take some time before we see the effects on inflation of the measures we have already adopted. If we raise too aggressively at coming meetings, we risk creating instability and severe fluctuations in the Swedish economy, which will make it harder to stabilise inflation at the target in the medium term.

I therefore consider that the profile of the interest rate path is good, with front-loaded raises followed by raises in smaller steps. I would, however, have preferred an interest rate path that levels off rather than indicating some probability of a rate cut. I would rather that we remain on a higher interest rate level than that we raise it so much that we are forced to cut the policy rate before the forecast period has even ended. A well-balanced monetary policy should strive to decrease, rather than amplify, fluctuations in economic activity so that inflation stays close to target in both the medium and longer run. In addition, the precision at the forecast horizon is very low. This policy path risks suggesting we are able to predict exactly when the interest rate path will peak, which is not realistic in an environment with unusually large fluctuations in both growth and inflation.

Allow me to summarise. I support a rate rise to 1.75 per cent at today's meeting. With this, the Riksbank's monetary policy is now clearly contractionary, which will contribute to economic activity slowing down and inflation returning to target. If inflationary pressures rise/fall, more/fewer rate rises than in the forecast may be appropriate.

Deputy Governor Henry Ohlsson:

To begin with, I would like to say that I support the proposal to raise the policy rate by 1 percentage point to 1.75 per cent, and the proposal for a path for the policy rate. In addition, I support the economic outlook and forecasts in the draft Monetary Policy Report.

Inflation has risen rapidly abroad. During 2021, the rate of inflation in the United States rose to 4.7 per cent. This year, inflation there has continued to rise. The draft Monetary Policy Report contains a forecast that inflation in the United States will reach 8.1 per cent this year. In the euro area, the rate of inflation began to rise somewhat later. For the year 2021 as a whole, inflation rose to 2.6 per cent. The forecast for the euro area in the draft Monetary Policy Report is 8.1 per cent in 2022. The trade-weighted (KIX-weighted) rate of inflation abroad was 3.1 per cent in 2021. It is expected to be 7.6 per cent in 2022, according to the draft Monetary Policy Report.

The rapidly rising inflation has led to powerful monetary policy reactions in many parts of the world. The annual average in 2022 for the KIX-weighted policy rate is assessed to reach 0.5 per cent. When the policy rate increases have an impact over the whole of the coming year, the forecast in the draft Monetary Policy Report is that the annual average will rise to 2.4 per cent for 2023.

CPIF inflation in Sweden was 2.4 per cent during 2021. It is expected to be 7.8 per cent in 2022, according to the draft Monetary Policy Report. Developments in Sweden have been fairly similar to those in the euro area. The policy rate in Sweden will reach an annual average of 0.7 with the monetary policy decision I am assuming we will make today. This decision means that the forecast for the annual average in 2023 is 2.5 per cent. My conclusion from this review is that inflation and the policy rate in Sweden will not be very different from inflation and policy rates abroad.

A fundamental starting point for monetary policy is that the CPIF has been the target variable for monetary policy since 2017. In other words, the rate of increase in the CPIF is the measure of how quickly the cost of living is rising, which is the starting point for the price stability target. The most recent inflation survey in August 2022 showed that the annual rate of increase in the CPIF was 9.0 per cent compared with the same month one year earlier. This is a far above the inflation target of 2 per cent. It is a very long time since the cost of living in Sweden increased as quickly as it has done during 2022.

Here it is natural to move on to my monetary policy considerations. Inflation expectations are an important element in judging the credibility of monetary policy when it comes to attaining the inflation target. It is an important observation that inflation expectations five years ahead among money market participants have remained at around 2.4 per cent in recent months. The most recent five-year measurement for money market participants from September 2022 is at 2.4 per cent on average.

I would like to emphasise that money market participants' inflation expectations are not formed in a vacuum. These actors at the same time form expectations of a number of macroeconomic key variables. These include, in addition to inflation, expectations of the coming monetary policy. In September 2022, money market participants expected a policy rate of approximately 2.4 per cent twelve months ahead, and a policy rate of 2.0 per cent 24 months ahead from September

2022. In other words, money market participants' expectations of inflation five years ahead of 2.4 per cent were based on the expectation of a less expansionary monetary policy.

The price increases we have seen over the year are not something that monetary policy can affect. But the high inflation risks setting off a spiral of price increases, wage drift, price increases, wage drift and so on in the near term. It is essential to ward off these tendencies in time. It is very clear to me that monetary policy needs to become much less expansionary. As I see it, it is therefore necessary to raise the policy rate substantially. It is also my assessment that today's relatively large increase can prove to be the least we can do. However, the policy-rate path entails a forecast of further hikes going forward, which is why I support today's decision.

It is important to emphasise that the earlier increases in the policy rate, together with today's large increase do not mean that monetary policy in Sweden differs to any great degree from that conducted in other countries. This is one of the factors behind the Swedish krona not having appreciated so far this year.

To summarise, I support the proposal to raise the policy rate by 1 percentage point to 1.75 per cent, and the proposal for a path for the policy rate. In addition, I support the economic outlook and forecasts in the draft Monetary Policy Report.

Dixi!

Deputy Governor Per Jansson:

Since our last monetary policy meeting at the end of June, we have received three new inflation outcomes, for June, July and August. In all the outcomes, inflation both with and without energy prices was higher than in the forecast in our most recent Monetary Policy Report from June. The forecast error has also had a tendency to grow over time, especially for inflation adjusted for energy prices. In August, CPIF inflation was 9 per cent, compared with a forecast of 7.5 per cent in our June report. The corresponding figures for CPIF inflation excluding energy prices are 6.8 and 5.7 per cent. Compared with the situation at our June meeting, when we had access to outcomes up to and including May, inflation with and without energy prices has therefore risen by 1.8 and 1.4 percentage points respectively. Our forecast, on the other hand, was based on a development in which both inflation measures were only supposed to increase marginally.

That the inflation situation is significantly problematic is also very clearly evident from our measures of underlying inflation. The median of the measures, which has now increased fourteen months in a row and since October 2021 has consistently been above the inflation target, is now 7.1 per cent, compared to 5.4 per cent when computed based on data up to and including May in connection with the meeting in June. In June, I noted that six of the seven measures that we regularly update exceeded 5 per cent. With the new inflation data received since then, none of the measures is below 6.5 per cent.

This year, the breadth of the price rise has gradually increased. The updated measures of underlying inflation now suggest that this is continuing and it is also unfortunately confirmed by the development of different sub-components of inflation. Grouped into the Riksbank's five main sub-components – capital stock, food, energy, goods and services – the rate of price increase in August is higher for all sub-indices compared with the situation in May. What is most striking here are the large upturns in the rate of price increase in food and goods. In terms of their contribution to the level of inflation in August, where the weights of the sub-components in the consumption basket also play a part, all sub-indices apart from the capital stock contribute roughly the same to the total price increase, just over 2 percentage points each.

The conclusion of this review of price developments is not encouraging. Inflation continues to rise rapidly and has now reached levels not seen since the beginning of the 1990s. There is little in the outcome data so far to suggest that the upturn is about to come to an end.[7] On the contrary, it has become increasingly broad during the year. Another factor is that our underestimations of the development of inflation have had a tendency to become increasingly large. As I have mentioned several times previously, it is crucial in the prevailing situation that the currently large and broad increase in prices is not expected to persist for a long time to come, or, to put it a different way, that longer-term inflation expectations do not start to overshoot the inflation target too much. If that were to happen, a wage-price spiral may occur, that could be very costly to break.

Fortunately, Prospera's new measurements of longer-term inflation expectations show that expectations are reasonably stable and in general remain just a few tenths of a percentage point above the inflation target. The new measurements since our last monetary policy meeting consist of surveys for September, August and July.

In the most recent survey for September, which is a large quarterly survey and therefore also measures the expectations of labour market organisations, five-year inflation expectations for money market participants were at 2.4 per cent, which was just less than a tenth of a percentage point higher than in the previous quarterly survey in June but unchanged compared with the

[7] As shown in the article "What indicates that inflation will fall back next year?" in the draft Monetary Policy Report, there are signs in smoothed data that certain monthly price increases have started to slow down.

measurement in August and actually slightly lower than in the July survey.[8] For all the surveyed groups, the figure in September was 2.3 per cent, unchanged compared with the survey in June.

In this situation, the long-term inflation expectations of labour market organisations are of course particularly important to monitor. Here, among employee organisations, an increase of just over a tenth of a percentage point, to 2.3 per cent, can be noted between September and June. Among employer organisations, expectations have instead fallen from 2.2 per cent to 2.0 per cent. Although the high inflation outcome for August was not known when the latest measurement in September was made, all these figures suggest that confidence in the inflation target is completely intact and still strong.[9] The importance of it remaining like this cannot be overstated.[10]

Due to the unexpectedly high outcomes for inflation, very large upward revisions to the forecast up until summer next year are now being proposed in the draft Monetary Policy Report. Inflation is now expected to peak at just under 11 per cent in early 2023. That inflation will be pushed down very rapidly in the second half of next year and at the beginning of 2024 has to do with the forecast for energy prices, which is based on current forward pricing.[11] This has no significance for either the development of more genuine inflationary pressures or monetary policy.

The forecast for inflation excluding energy prices has also been substantially revised upwards. Excluding energy prices, price increases are estimated to peak at just less than 8 per cent for a couple of months at the end of this year. For this inflation measure, which is not affected by the assumption for energy prices, the upward revision of the forecast continues a bit longer, some way into 2024. I support the inflation-forecast proposal presented in the draft Monetary Policy Report and I also support all the other economic assessments made there.

In light of the ominous inflation picture that the draft report presents and I have discussed here, I furthermore support the proposal to now increase the policy rate by 1 percentage point to

[8] I am focusing as usual on the expectations for CPI inflation rather than for CPIF inflation, as the response rate for CPIF inflation is often lower. As we are now in a rate-hike cycle, it may become more important going forward to follow and emphasise the expectations for CPIF inflation. For five-year inflation expectations, however, the differences between the two measures are currently small.
[9] The expectations for CPIF inflation among labour market organisations are furthermore slightly lower than the expectations for CPI inflation, 1.9 per cent for employer organisations and 2.2 per cent for employee organisations.
[10] The longer-term inflation expectations estimated from the market pricing of financial contracts have fallen in general since our June meeting. However, for various reasons that I have elaborated on earlier, I attach less importance to these.
[11] For more information on this, see the article "What indicates that inflation will fall back next year?" in the draft Monetary Policy Report.

1.75 per cent. And I also share the view that further increases of the policy rate will very likely be needed over the next six months.

Inflation is now very high and the Riksbank has underestimated the strength of price increases several times since the beginning of the year. A question one therefore may ask is whether we have not actually lost sight of the whole development and will now for a long time have to accept that the inflation rate will be significantly higher than the target of 2 per cent. My answer to this question is a resounding no.

For many years up until around the turn of the year 2021–22, the main challenge for monetary policy has been to create sufficiently high inflationary pressure so as not to undershoot the inflation target by too much for too long. That this has been difficult is largely due to the policy rate having a lower bound – a limit below which it is not possible to reduce the rate further or, in any case, the negative side-effects of doing so risk being very large. But regarding our options to increase the policy rate, there is no upper bound in the same way. Obviously, rate rises are also associated with costs, but the negative side-effects of a deeply negative rate of a several percentage points probably correspond to a positive rate in double-digit territory. In this case, the difficulties in returning inflation to target are not so much a question of more or less binding limitations, but more of in which time perspective it is deemed reasonable to do so. My view up to now has been that in the prevailing situation, it is extremely important to give Swedish wage formation stable conditions, with inflation back at target well within the time period during which the forthcoming wage agreements can be expected to apply. I continue to maintain this view and, just as before, think that inflation close to target around the turn of the year 2023–24 is a good benchmark.

It being possible to increase the policy rate a lot obviously does not mean that it is desirable to do so. The best scenario is obviously if it is possible to return inflation to target with relatively cautious rate rises. Unfortunately, the policy rate now needs to be increased more than we previously thought but it is still not a question of a dramatic hike to very high levels. The assessment is that the policy rate will peak at around 2.5 per cent some time next year, and then slowly fall to slightly lower levels.

Whether it will be possible to hit the inflation target with this plan for monetary policy largely depends on how much support such a development receives from price- and wage-setting and the design of fiscal policy. The forecast assumes that support will exist but there are several risks surrounding this assumption.

For example, I continue to be rather worried about large price increases from companies that do not seem to have a need for them looking at their profitability and cost developments. Such price rises not only lead directly to unnecessarily high inflation but also increase the risk of compensatory wage increases that can otherwise could be avoided.

However, wage formation risks leading to problematically high wage increases even with companies that are careful and responsible when it comes to pricing. In the draft Monetary Policy Report, the forecast for wage increases is now slightly higher than before. But a rate of increase that temporarily peaks at around 3.5 per cent in 2023 and then falls slightly thereafter is hardly something to have sleepless nights about. But a difference compared to previously is that a number of union representatives have now started to talk about the need for real wage increases. Some temporary rise in nominal wage increases during the period when inflation peaks may indeed be reasonable, but it is hardly possible to achieve a rate of increase for nominal wages that compensates fully for inflation. And even when the compensation is limited, it requires a wage negotiation profile that makes it very clear that it is indeed a question of a temporary effect.

A circumstance that can reduce the need for large compensatory wage increases is a well-designed fiscal policy. Here it is a question of trying to, in a targeted manner, compensate households and companies that have been particularly hard-hit, without seriously impeding the Riksbank from safeguarding the inflation target. When support measures are designed, difficult trade-offs must also be made between the immediate need for support and other economic ambitions and targets, such as reduced energy consumption and a transition to renewable energy. From the Riksbank's perspective, broad stimulation measures that sharply drive up aggregate demand and thus inflation are obviously not desirable.

Deputy Governor Martin Flodén:

I support the proposal to raise the policy rate by one percentage point to 1.75 per cent, the proposed policy rate forecast and the draft Monetary Policy Report.

The proposal is to raise the policy rate by one percentage point, which may sound like a very large adjustment. This would make it the largest policy rate rise the Riksbank has made during the period with an inflation target. But the size of the rate rise must be seen in light of how rapidly the inflation outlook has changed. From this perspective, the rate rise is not remarkable. And the Riksbank has previously reacted with even greater rate *cuts* when the economy has rapidly changed, for example during the global financial crisis in the autumn of 2008.

There is no doubt that the rate rise will be noticeable in many household and corporate cash flows and will contribute to economic activity slowing down. But it will take time for monetary policy to have its full impact and it is difficult, at present, to assess the speed and extent of its effects on economic activity. This also makes it uncertain how much inflation will be dampened by the monetary policy tightening we decided upon at our meetings in April and June and that we will decide upon today.

Our assessment is that, even after a rise of one percentage point today, the policy rate is still a little lower than what is needed to bring inflation back to two per cent. It is therefore likely that the rate will also have to be raised at the next monetary policy meeting in November. Our forecast indicates that it will then most likely be a smaller rise than today and that we will then be close to a rate level that could be high enough, even in the medium term.

But there is still considerable uncertainty over this assessment. By the time of the meeting in November, conditions may have changed, and so may our assessment of how much more the rate will need to be raised. It is easy to envisage both scenarios in which the rate needs to be raised by more than in the forecast and scenarios in which it is appropriate to raise the rate by less. I can also imagine scenarios in which it is appropriate to keep the rate unchanged at the next monetary policy meeting. However, I find it difficult to imagine scenarios in which a rate level of 1.75 per cent in November turns out to be too high.

It is precisely this insight that makes me consider it appropriate to raise the rate by one percentage point today. Despite the great uncertainty over the development of inflation and the slowdown of economic activity, we know that the level of interest rates needs to be higher. Inflation has risen very rapidly and inflationary pressures have changed from weak to strong over a short time. Central banks abroad are facing similar developments and are raising their policy rates rapidly. In such an environment, there is no reason to raise the policy rate in small steps. Rather, the uncertainty would increase if we were to raise the rate slowly in an attempt to evaluate each step as this would lead to expectations of large, but uncertain, future rate rises. In addition, there would then be a greater risk of confidence in the inflation target being undermined and that messy price- and wage-setting would weaken real economic developments in the somewhat longer term, too.

In connection with this reasoning, I note that confidence in the inflation target is still strong and that long-term inflation expectations have been relatively stable. But, of course, this is based on expectations that the Riksbank will do its job and tighten monetary policy sufficiently and quickly enough for inflation to fall back to 2 per cent in a timely manner.

I also note that, at the last three monetary policy meetings, including today’s meeting, we both have raised the policy rate by increasingly large steps and have raised the policy rate by more than we indicated in the previous forecast. This is an insight that we have taken on board and I consider that the proposed decision today has improved the conditions for not finding ourselves in a similar position at the next meeting too. As I have already implied, I consider that the uncertainty over the decision in November is balanced – the need for rate rises in the near term could just as easily be smaller or greater than in our forecast.

The draft Monetary Policy Report includes an article that shows that many Swedish households and companies will be affected rapidly and substantially by the policy rate now rising. Another expenditure item that is now changing rapidly and substantially is energy expenses. This is a larger expenditure item than the mortgage rate for the average household, even if we consider only electricity expenses.

It is conceivable that electricity prices will become about twice as high over the coming 12 months as they were in 2020, while interest expenditures will probably not rise as fast (see, for example, Figures 38 and 52 in the draft Monetary Policy Report). The higher electricity prices may therefore have very strong effects on households' finances in the near term. And many companies will be affected similarly.

The energy crisis in Europe is often described as a negative supply shock that is making us poorer by worsening our terms-of-trade. Transferring this conclusion to the Swedish economy is not entirely straightforward because we are a net exporter of electricity. It is, however, clear that the energy crisis is entailing a large redistribution of resources between different agents in the economy.

Our forecast assumes that fiscal policy in 2023 will redistribute a significant part of the higher electricity expenses back to households and companies. Such a support programme could have direct effects on the measured level of inflation, as described in an article in the draft report. As it concerns a significant amount, such a support programme could also have major effects on economic activity and thus on inflationary pressures. Monetary policy has to take this into account.

In conclusion, I would like to say a few words about our asset purchases. At the monetary policy meeting in June, we decided to reduce the purchasing rate compared with earlier decisions. The proposal in the draft Monetary Policy Report is that this decision still applies but that we now clarify that we expect to conclude purchases at the end of the year. Although I consider that we could have terminated these purchases now without any problems, I am able to support the proposal, as the purchases will be relatively modest over the rest of the year.

Governor Stefan Ingves:

I support the forecasts and assessments made in the draft Monetary Policy Report. Since the last monetary policy meeting in June, inflation has continued to rise more than expected and, once again, we have had to revise the inflation forecast upwards. In light of this, the conclusion is quite simple for me – the policy rate needs to be raised by more than we had previously envisaged. Internationally, we also see how several central banks are raising their policy rates at a brisk pace. I therefore support the proposal to raise the policy rate by one percentage point, from 0.75 to 1.75 per cent. Our forecast for the policy rate indicates continued large increases at coming monetary policy meetings, which I consider is entirely necessary to bring inflation back to target in the long run. Inflation targeting is now being put to the test. To safeguard credibility in the inflation target, monetary policy needs to have full focus on bringing inflation back to the target within a reasonable time. Long-term inflation expectations have not moved noticeably yet. This is positive but makes it important that we now emphasise the importance of the inflation target and our great need of a clear tightening of monetary policy.

The global economy continues to be characterised by the economic effects of the pandemic and Russia's invasion of Ukraine. Measures taken over the last two years or so to manage the pandemic have given rise to various kinds of supply and demand shocks, which have still not worn off. These were joined this year by the dramatic effects on prices, primarily of energy and food, following in the wake of the war in Ukraine. These major shocks have resulted in the major macroeconomic volatility and uncertainty that has characterised the shape of economic policy in Europe and many other parts of the world over a longer period. And, since a little over a year ago, the rate of inflation in most advanced economies has risen to levels not seen for several decades.

It is difficult to make forecasts in an environment where geopolitical developments are hard to assess and unpredictable. Our latest forecast for growth in the world economy, KIX-weighted, indicates a slowdown is on the way after the recovery in 2021 and a decent first six months in 2022. Our forecast for growth in 2023 has been revised down to 1.1 per cent, followed by 2.0 per cent in 2024. In my opinion, however, these figures are highly uncertain. On one hand, the supply shocks that have impacted growth so far could be resolved but, on the other, new shocks could reduce growth. Our forecast for KIX-weighted inflation has been revised up to 7.6 per cent this year and 4.5 per cent next year. Of course, the same uncertainty applies to these forecasts, as the same shocks that are affecting growth are also affecting inflation.

Activity in the Swedish economy has been good so far in 2022. The employment rate on the labour market is at a record-high level. However, a slowdown is now taking place, among other reasons due to the high energy prices and lower global growth. The forecast for Swedish GDP growth has been revised downwards for all years in the forecast period. Next year, the level of GDP is actually expected to fall slightly before growth returns to positive in 2024.

Unemployment, which is expected to be about 7.5 per cent this year, will rise somewhat over the forecast period.

Since the previous monetary policy meeting at the end of June, we have received three new inflation outcomes, and they have all been higher than our forecasts from the Monetary Policy Report in June. The most recent outcome, CPIF inflation in August, was 9.0 per cent, which was 1.5 percentage points higher than our old forecast. CPIF inflation excluding energy also surprised on the upside and, in August, came in at 6.8 per cent. The annual average for the CPIF is expected to be 7.8 per cent this year, 5.1 per cent in 2023 and 1.6 per cent in 2024. This is altogether too high in the short term!

The last 18 months have entailed a new scene for central banks in most advanced economies. Low inflation and low interest rates, and a widespread expectation that this would persist for a long time to come, have turned into high inflation and rising interest rates. Most major central banks have completely rethought their monetary policies. As we all know, this applies to the Riksbank too.

Inflation has increased in Sweden and around the globe. This was unexpected and we have, unfortunately, made major forecast errors several times. The development of inflation has been completely different than we expected less than a year ago, an example of the increased macroeconomic volatility I initially mentioned. And, as I also said, the new scene has emerged swiftly. As recently as in April 2020, CPI inflation was negative, at -0.4 per cent. In August 2022, it was 9.8 per cent and, in our forecast, CPI inflation will peak at just over 14 per cent at the start of next year. Our target variable, the CPIF, has gone from -0.4 per cent in April 2020 to 9.0 percent in August 2022, with a peak of almost 11 per cent expected at the start of 2023. These figures show how rapidly – and unexpectedly – inflation can rise. It is therefore important that we now act forcefully with our monetary policy. This is more than enough reason to raise the policy rate by 1 percentage point today.

Another reason to justify the unusually large rate increase is that we need to make sure we have the right monetary policy in Sweden, compared with the monetary policies being implemented in the major currency areas. Like so many times before, Swedish monetary policy needs to be positioned just right in relation to US and European monetary policies. So far this year, the ECB has raised its policy rate by 1.25 percentage points and the Federal Reserve has raised its by even more. Market expectations are prepared for continued rises over the rest of this year and next year. In the prevailing situation, with Swedish inflation that is far above the inflation target, we need to be proactive and ensure that the Swedish policy rate maintains a comfortable distance from the ECB policy rate. If interest rates abroad are raised, we need to follow along upwards at the same pace at very least. Waiting and thereby risking inflation receiving a further upwards push from a depreciating krona would, in my opinion, be far too dangerous a path to take. One scenario that must be avoided is raising the policy rate too little so that inflation becomes entrenched on high levels.

At the same time, I do not think that the significance of a one percentage point hike should be exaggerated. Large changes in the policy rate have taken place before, although, as a rule, these have been major policy rate cuts in troubled circumstances. However, we are in a serious position now and the credibility of the inflation target must be defended. And a credible monetary policy requires preparedness to both cut and raise the rate enough to allow the inflation target to be met within a reasonable time. At the same time, it can be noted that a policy rate level of 1.75 per cent is not high. Under the prevailing levels of inflation, the real interest rate remains far below zero.

Our policy rate adjustments will lead to a higher general level of interest rates in the Swedish economy. Households and companies will notice this in many ways. But failing to act now to bring inflation down would lead to even more substantial and negative effects later on. Our experience, for example from Sweden in the 1970s and 1980s, shows that a high and varying rate of inflation has a heaviest impact on those who are worst off. The value of incomes and pensions is undermined while rents are adjusted upwards. The functioning of the economy deteriorates, leading, over time, to lower growth and weaker employment. In other words, a loss of confidence in the inflation target can have serious effects for large social groups. At the same time, it is important that different policy areas now pull more or less in the same direction. For example, reducing amortisation requirements now would only lead to an even higher interest rate later on.

In conclusion, inflation has continued to rise in an unexpected manner and we are far above our inflation target of two per cent. Today, therefore, we need to raise the policy rate more than we envisaged in June. We are doing this to ensure that this year’s high inflation does not become long-lasting. Our mission is clear – safeguarding confidence in the Swedish inflation target – and ensuring that inflation returns to our target of two per cent.

§4. Monetary policy decision

The Executive Board decided

- to increase the policy rate to 1.75 per cent and that this decision apply from Wednesday 21 September 2022,

- to establish the Monetary Policy Report according to the proposal, Annex A to the minutes Monetary Policy Report,
- to publish the monetary policy decision with the motivation for it in a press release on Tuesday 20 September at 09.30,
- to publish the minutes from today's meeting on Thursday 29 September 2022 at 09.30.

This paragraph was verified immediately.

Minutes taken by:

Christina Håkanson

Iida Häkkinen Skans

Verified by:

Stefan Ingves

Anna Breman

Martin Flodén

Per Jansson

Henry Ohlsson

SVERIGES RIKSBANK
103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 - 787 00 00
Fax +46 8 - 21 05 31
registratorn@riksbank.se
www.riksbank.se