Monetary policy minutes

June 2022

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

Summary

The Riksbank needs to prevent high inflation becoming entrenched in price- and wage-setting, and to ensure that inflation returns to the target. The Executive Board therefore decided at its monetary policy meeting on 29 June to increase the policy rate by 0.5 percentage points to 0.75 per cent and to reduce the Riksbank's asset holdings faster during the second half of the year than what was decided in April.

The members observed that inflation has continued to rise rapidly and that price increases were spreading, in a worrying fashion, throughout the economy. A significant factor in this context is that companies have raised their prices more than they normally do in relation to the development in costs. The members noted that the forecast for inflation has been revised up significantly and several members pointed out that the framework for Swedish monetary policy, wage formation and fiscal policy are now being put to the test for the first time in a high-inflation environment. To safeguard confidence in the inflation target, the members were unanimous that monetary policy needs to be tightened further than they assessed in April. A unanimous Executive Board supported the decision to raise the repo rate from 0.25 to 0.75 per cent and to further reduce the pace of the Riksbank’s asset purchases during the second half of the year.

One important issue raised by a number of members is the high level of indebtedness among economic agents and how it is making it more difficult to assess how high interest rates will need to be for inflation to fall back. They pointed out that there is considerable uncertainty regarding future developments, and emphasised that forecasts are exactly that, forecasts and not promises, and that monetary policy may need to be constantly reviewed and adapted.

Several members also emphasised that they are prepared to do what is necessary to bring inflation down, even if this were to lead to weaker developments in the real economy in the near term. They also pointed out that it is important to act quickly with policy-rate increases in the immediate future to prevent a problematic development that requires even greater monetary policy tightening further ahead.

MONETARY POLICY MINUTES
Executive Board, No.3

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DATE: 29 June 2022
MEETING TIME: 09.00

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

Michael Lundholm, Deputy Chair, General Council, remotely

Vesna Corbo
Charlotta Edler
Paul Elger
Heidi Elmér
Dag Edvardsson
Mattias Erlandsson
Jesper Hansson, remotely
Christina Håkanson
Jens Iversen
Maria Johansson (§ 1-3a)
Kristian Jönsson, remotely
Pernilla Meyersson
Ann-Leena Mikiver
Marianne Nessén, remotely
Carl-Fredrik Pettersson (§ 1-3a)
Åsa Olli Segendorf
Maria Sjödin

It was noted that Paul Elger and Christina Håkanson would prepare the draft minutes of the monetary policy meeting.

§3a. Economic developments

Market developments since the last monetary policy meeting

Carl-Fredrik Pettersson from the Markets Department began by presenting the latest developments in the financial markets. Expectations of policy rates have continued to rise globally since the monetary policy meeting in April, given the unexpectedly high outcomes for inflation. Central banks are in general expected to increase their policy rates substantially in the near term. The US Federal Reserve increased its policy rate by 0.50 percentage points in May and 0.75 percentage points in June, and is expected to increase it by a further 2 percentage points by the end of the year, according to market pricing. Communication from the European Central Bank at its meeting in June has been interpreted by market participants as an intention to increase the policy rate by 0.25 per cent in July and 0.50 percentage points in September. According to market pricing, the policy rate is expected to be around 1 per cent at the end of the year.

Higher policy rates have contributed to higher government bond yields. The rate increases have affected the so-called peripheral euro countries' government bond yields even more, which may be a challenge for the ECB when the policy rate is increased going forward. The ECB has therefore signalled that it will produce a new tool to manage yield spreads. Moreover, reinvestments in the framework of the pandemic programme will be used flexibly and in particular aimed at the countries where the monetary policy transmission mechanism functions less well. Corporate bonds and the average interest mark-up on these in relation to government bonds have also risen, more so in Sweden and Europe than in the United States.

Higher interest rates and funding costs for companies, as well as poorer growth prospects, have meant that stock market indices in the United States and Europe have fallen significantly. At the same time, the markets are reflecting a high level of uncertainty linked to the war in Ukraine and the high inflation. This uncertainty is expressed, for instance, in high and rising volatility in several different markets. In the energy markets, oil and gas prices have been rising since the April meeting, partly as a result of the EU's forthcoming sanctions against Russian oil and because Russia has stopped supplying natural gas to some European countries.

Expectations of rate increases by the Riksbank have also increased significantly, where higher inflation outcomes than expected have contributed. Most analysts believe that the Riksbank will increase the policy rate by 0.50 percentage points at today's meeting, and pricing indicates increases of almost 2 percentage points before the end of the year, while a more modest pace is expected thereafter. With regard to asset purchases, the Riksbank's plan is expected to remain unchanged in 2022 and reinvestments are then expected to be relatively small and to have little significance in relation to the rate increases.

Regarding the yield spread between corporate bonds and government bonds, Deputy Governor **Per Jansson** noted that it is worrying, and a little difficult to understand, why this is greater in Sweden than in other countries and he called for regular reporting and preparedness on this issue going forward. Carl-Fredrik Pettersson replied that this can largely be explained by the Swedish index being less broad than that in the euro area, for instance, and containing a larger share of bonds with lower credit ratings.

The situation in the banking sector and financial stability

Kristian Jönsson, Deputy Head of the Financial Stability Department, described the situation in the housing market and the funding situation for companies and banks. Housing prices fell in May, for the second month in a row. Adjusted for seasonal effects, they fell by 1.2 per cent. With regard to the annual rate of increase, which has declined in recent months, housing prices according to HOX had increased by 2.9 per cent in May, of which single-family houses had increased by 2.5 per cent and tenant-owned apartments by 3.6 per cent. The number of sales of tenant-owned apartments and single-family houses nationwide was a good 15 per cent lower in May than in the same month last year. An increasing number of households also appear to believe housing prices will fall. In June, SEB’s housing price indicator fell by 34 units, and a majority of households now believe prices will fall in the coming year.

The corporate sector is still being affected by production and delivery problems, but on the whole companies are experiencing good earnings and have well-filled order books. However, there is concern among consumer-related companies that households will consume less going forward. Growth in debt among companies is high and mainly fuelled by bank loans. Funding costs are much higher in the corporate bond market than for bank loans, where interest rates have not increased to the same extent. The number of company bankruptcies remains at roughly the same level as in the years prior to the pandemic.

In the commercial property market, which the Financial Stability Department has talked a lot about, the rental market is strong. On the whole, property values have risen so far this year. According to statistics for May, the rate of growth in commercial property companies’ borrowing via banks and the capital market remained high. However, in common with other companies, many property companies are now facing much higher funding costs, especially via the capital market. In the long term, this will lead to higher direct yield requirements and thereby lower property values.

Yield levels on Swedish covered bonds have continued to follow the general upturn in long rates. There has also been a relatively strong increase in risk premiums recently, as a result of the general uncertainty regarding future interest rates, inflation, poorer macrofinancial developments and Russia's war in Ukraine.

With regard to interbank rates, STIBOR, which reflects interest rates on short interbank loans in Sweden, has risen to around 0.75 per cent for the 3-month rate. One can also clearly see that the market is pricing in future rate increases from the Riksbank. USD LIBOR, which reflects loans between banks in US dollars without collateral, has continued to rise and the 3-month rate is now at just over 2 per cent. Finally, SWESTR, which is a transaction-based overnight reference rate, has also risen in line with the most recent increase in the policy rate and is currently at 0.15 per cent. On the whole, interest rates are following the rate hikes made by the central banks.

Another important part of banks' funding, in addition to market funding, is deposits. Bank deposits remain high, which means that the banks' need of market funding is still low. Deposit rates are in general still around zero per cent, for instance on ordinary transaction accounts. However, fixed rates are positive. Finally, mortgage rates have increased in recent months. Above all those for longer fixed periods, although variable rates have also begun to rise a little.

The current monetary policy drafting process – new data and forecasts

Mattias Erlandsson, Deputy Head of the Monetary Policy Department, described the current assessment of macroeconomic developments since the monetary policy meeting on 27 April and the proposal for a monetary policy decision. The background material for today's decision has been discussed on five occasions, on 23 May and on 14, 15, 17 and 21 June. The preparation for today's meeting has largely concerned the development of inflation. The outcomes since the April meeting have again been higher than expected in the Riksbank's forecast at that time. An important question has been to analyse incoming statistics and other information for signs that inflation is spreading via higher inflation expectations and price increases that are not so clearly linked to rapidly rising cost increases among companies. This could be an early sign that the high inflation is becoming entrenched. The analysis is described in the draft Monetary Policy Report, including in an article.

Several 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. The major uncertainty is evident from the Riksbank's forecast errors for inflation, which have been substantial over the past year. The reasons for the upturn in inflation and the forecast errors are discussed in a Staff Memo that will be published on 30 June.

Other important issues in the drafting process have concerned global economic activity, where the continuing war in Ukraine and sanctions against Russia, high inflation and higher interest rates entail risks of weaker developments. Another development than that described in the forecasts in the draft Monetary Policy Report can affect the formulation of monetary policy both in Sweden and abroad.

Mr Erlandsson then briefly summarised the international forecasts in the draft Monetary Policy Report. Inflation is high, and in the United States it has been around 8.5 per cent in recent months. In the euro area, the upturn has continued and the most recent measurement there was also just over 8 per cent. Underlying inflation is still higher in the United States than in the euro area, where the upturn in inflation is driven by energy prices to a greater extent.

The rapid upturn in inflation means that the major central banks are now tightening their monetary policy or planning to start doing so soon. Compared with previous rate-hike cycles, the increases are now being made at a rapid pace and the forecast for the weighted policy rate abroad has been adjusted up. Higher inflation and tighter financial conditions are expected to subdue global growth. In the forecast it is not a question of any rapid slowdown – KIX-weighted growth is expected to be around 2 per cent a year in the coming years – but there is considerable uncertainty.

With the tighter monetary policy, inflation is expected to fall next year. The lower global growth is expected to bring an end to rising commodity prices. There are already signs of this and it is also in line with pricing in the forward markets. At the same time, the supply shocks that became evident last year are gradually affecting prices to a lesser degree. In 2024 and 2025 inflation abroad is expected to be roughly in line with central bank inflation targets.

The initial position for the Swedish economy is relatively strong, but the economy is now entering a period of lower growth. Companies' optimism has fallen somewhat in the recent surveys for the month of May, but is still higher than normal, while household confidence has fallen to low levels. The forecast for GDP growth has been revised down compared to the assessment in April. Higher inflation and rising interest rates undermine households' purchasing power and are expected to contribute to unusually weak household consumption this year and next year. The higher housing costs at the same time will reduce the high demand for housing, leading to lower housing construction. All in all, growth is estimated to be on average just over 1 per cent a year in 2022–24.

Labour demand indicators, such as companies’ recruitment plans, point to continued strong development in employment in the near term. When GDP growth slows down, however, employment is also expected to increase more slowly. Unemployment has been adjusted upwards in the forecast compared to the assessment in April, and is now expected to rise to 8 per cent towards the end of the forecast period. The lower growth going forward is expected to cause resource utilisation in the Swedish economy, which to begin with is somewhat higher than normal, to fall and be somewhat lower than normal towards the end of the forecast period.

Since the Monetary Policy Report in April, Statistics Sweden has reported outcomes for inflation in April and May. Price developments were unusually strong in both of these months and in May CPIF inflation was 7.2 per cent. This was almost one percentage point higher than the forecast in April. The upturn in inflation this year has been primarily driven by higher prices for goods and food, but in April and May service prices also increased faster than expected and inflation excluding energy prices was 5.4 per cent in May. Developments show that the upturn in inflation has now broadened further, which is also confirmed by the Riksbank's various measures of underlying inflation.

Inflation expectations have also risen, particularly on the shorter horizon. The rise in more long-term inflation expectations is modest and wage growth has not increased, according to the available statistics. The fact that service prices are increasing much faster, at the same time as companies appear to be able to increase their margins despite the rapid cost increases in many sectors, means that there are some signs that the behaviour of price-setters in the economy has changed.

The forecast for CPIF inflation excluding energy is that it will rise to just over 6 per cent at the end of the year. Energy prices are also expected to be higher now during the second half of this year than in the corresponding period last year, and CPIF inflation is expected to be over 7 per cent for the remainder of 2022. Cost pressures from international prices are expected to gradually decline going forward, contributing to a fall in inflation next year. The weaker domestic demand will also contribute to the downturn, as companies cannot increase their prices as much without losing market shares. From 2024 onwards, inflation is expected to be close to 2 per cent. The forecast assumes that the current high inflation does not make a significant impact on price- and wage-setting in the medium term. All in all, inflation is expected to be 6.9 per cent on average this year, which is an upward adjustment of 1.4 percentage points since April. The forecast is also adjusted upwards for 2023.

The forecasts are based on the monetary policy that is expected to gain majority support from the Executive Board at today's meeting. In brief, this entails the policy rate being increased to 0.75 per cent at today's meeting and that the rate, with relatively high probability, will be raised by 0.50 percentage points in September and November. After that, the policy rate, with high probability, will be raised further so that after the meeting in February it will be between 1.75 and 2 per cent. The forecasts also include deciding on purchases of bonds for SEK 18.5 billion during the second half of 2022. This replaces the earlier decision on purchases of SEK 37 billion in the second half of the year. After this, the holdings are expected to continue to decline in the coming years. Annex B to the minutes presents the proposal for a decision on asset purchases in the second half of 2022 in greater detail. The annex also contains a proposal for a decision that the Riksbank shall only purchase corporate bonds issued by companies that report their annual emissions of greenhouse gases in accordance with the recommendations of the Task Force on Climate-related Financial Disclosures. It is proposed that this decision will apply from 1 September 2022.

§3b. The economic situation and monetary policy

Deputy Governor Anna Breman:

I support the proposal to increase the policy rate from 0.25 to 0.75 per cent, the forecast and the policy-rate path in the draft Monetary Policy Report. I also support the proposal to further reduce the bond holdings and other decisions in accordance with Annex B to the minutes.

High inflation is harmful to the Swedish economy. The inflation is painful for households and companies and risks leading to impaired price- and wage-setting in both the short and the long term. Therefore, the policy-rate path now indicates several increases in the near term and then slower increases next year. This is a well-balanced monetary policy with front-loaded rate hikes as it takes time for monetary policy to have an impact. It is important to act now and then raise at a slower pace and let rate increases take effect throughout the economy. Allow me to comment on three aspects that influence the monetary policy considerations at today's meeting: the inflation outcomes, inflation expectations and the effect of higher interest rates on the Swedish economy.

First, the inflation upturn is broad. In the latest inflation numbers, it is primarily service prices that have increased more rapidly than expected. A series of serious and unexpected shocks to the global economy triggered the increase in inflation: a severe pandemic, Russia's invasion of Ukraine and the lockdowns in China. These global factors remain and contribute to the high inflation, but inflationary pressures are increasingly driven by domestic factors and we are now seeing a rapid rise in service prices as well. New data since April, an upward revision of the GDP outcome for last year and new information about companies' price-setting behaviour, provide evidence of the increasing role of domestic factors. Let me explain why this is important.

Swedish GDP has been revised up for 2021 as can be seen in the draft Monetary Policy Report.[1] We already knew that the Swedish economy has recovered well after the pandemic. We now see that the strength of the recovery was greater than previous statistics indicated. Strong demand in combination with supply disruptions have enabled companies to change their price-setting behaviour. New statistics shown in the draft Monetary Policy Report indicate not only that companies have managed to pass on higher costs to consumers, but also that their profit margins have increased. If companies change their price-setting behaviour more permanently, there is a greater risk of the rise in inflation becoming persistent. A broad increase in inflation justifies a rate hike of 0.50 percentage points at today's meeting.

Second, short-term inflation expectations continue to rise. Companies' and households' inflation expectations are at high levels. Research shows that goods and services bought often by households affect inflation expectations more than goods and services that are purchased less often. Energy and food are such goods, something which I discussed in a speech in March, and they are also goods that households cannot do without.[2] It is important that short-term inflation expectations do not spill over into long-term inflation expectations. It is therefore positive that Prospera's survey still indicates long-term inflation expectations of close to 2 per cent. Keeping long-term inflation expectations close to two per cent is another reason for increasing the policy rate at today's meeting.

Third, rate increases and reduced bond holdings will be effective measures in order to return inflation to the target. But let me emphasise again that it takes time for monetary policy to have effect. It takes time before households and companies adapt their behaviour to higher interest rates. Some companies are bound by contracts with fixed prices and long periods between order and delivery. This means that there will be a lag before prices stabilise. In addition, households

[1] Even though Swedish GDP temporarily fell in the first quarter of this year in connection with the wave of the pandemic at the beginning of the year, the level of activity is high.
[2] See speech by A. Breman (2022), 23 March 2022, Sveriges Riksbank, Inflation and monetary policy in the shadow of war.

and companies have different maturities on different types of loan. They will therefore gradually feel the impact of higher interest expenses and adapt their behaviour over time.

The rate path indicates a policy rate close to two per cent at the beginning of next year. At that time, it is highly likely that we will be facing a scenario of weak growth while inflation remains at a high level. Only at the end of next year do we expect to see a clear decline in the inflation rate and not until at some point in 2024 is inflation expected to be back close to 2 per cent.

That inflation will not fall back in the near term, despite rate increases, does not mean that monetary policy is not effective but reflects the fact that it takes time for economic agents to adapt to new interest rates. If we increase the policy rate too little in the near term, it may lead to more rate hikes being required than the policy-rate path now indicates in order to stabilise inflation, with negative effects on the real economy and the labour market. I therefore support raising the policy rate by 0.50 percentage points at today's meeting and similar hikes may be justified at the forthcoming meeting.

I would also like to mention that I support reducing the pace of reinvestments of maturing bonds during the second half of the year. I expect reinvestments to then decrease further next year or cease completely.

Allow me to reiterate what I said at the last meeting about asset holdings. My assessment is that when rate hikes and reduced bond holdings happen simultaneously, they reinforce each other. This makes comparison with previous rate-hike cycles difficult as the Riksbank did not have the same substantial asset holdings then. A policy-rate path that peaks around 2 per cent may seem relatively modest with inflation of around 7 per cent. But it must be seen in the light of rate hikes being combined with asset tapering and of households and companies being more indebted today.

As always, monetary policy may need to change direction. My assessment is still that the risk picture is on the downside for growth and on the upside for inflation. In other words, inflation is more likely to go even higher than in our forecast than to go lower. I emphasised at the monetary policy meeting in April that "If inflation goes even higher and becomes even more persistent than in our forecast, I will support doing what is necessary to attain the inflation target, including more rate hikes than are in the current path and/or a faster tapering of asset holdings." This still applies.

We need to be prepared for the possibility that the return to low and stable inflation will be painful for the Swedish economy and demand further measures from the Riksbank. Weaker short-term growth when interest rates rise must be weighted against the long-term economic gains of 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.

My last comment concerns the risks in the near term and what these mean for the forecast. Sweden and Europe are facing a tough autumn and winter. Global developments are currently characterised by a protracted war in Ukraine, lockdowns in China and effects of climate change in the form of heatwaves, floods and fires. This affects energy and food supply, risks driving up energy and food prices further and creating uncertainty about global value chains. All these factors suggest that we need to be prepared for low growth and high inflation, but also for major fluctuations in GDP and inflation in the coming year.

Since the pandemic hit, we have had large and rapid fluctuations in GDP and inflation. The volatility has also made forecasting more difficult and will continue to make it difficult in the coming years. Forecasts are based on new data and forward-looking indicators, but also consider historical correlations between different variables, such as the labour market and inflation, or producer prices and consumer prices. In recent years, these historical correlations have not worked well when it comes to forecasting. I wish to recommend the well-written staff memo that evaluates our forecasts.[3] It learns from forecast errors and discusses the continued development of our analysis going forward.

Allow me to summarise. It takes time for monetary policy to have effect. Which is why it is important to act now and not wait. To safeguard the inflation target, I support a rate hike of 0.50 percentage points at today's meeting. I also back the proposal to further reduce reinvestments of bonds during the second half of the year.

Finally, I would like to thank Cecilia for her excellent collegiality over the years. You have made a considerable contribution to the work of the Riksbank and always with the best interests of the Riksbank and Sweden at heart. You have also focused on issues that are central to all central banks – the future of money. It is no easy task to drive change in an organisation that is 354 years

[3] See J. Johansson, M. Löf, P. Stockhammar and I. Strid (2022), "Vad förklarar Riksbankens prognosfel för inflationen?" (English translation: "What can explain the Riksbank's forecast error for inflation?"), *Staff Memo*, June, Sveriges Riksbank. In Swedish only.

old. You have done it with masterly skill and I would like to thank you for your efforts and I wish you all the best for the future.

Deputy Governor Henry Ohlsson:

To start with, I support the proposal to increase the policy rate to 0.75 per cent and the proposed policy-rate path. I also support the proposal regarding asset purchases in Annex B to the minutes. In addition, I also back the economic outlook and forecasts in the draft Monetary Policy Report.

We are living in very challenging times. After the 1990s crisis there were major changes in Sweden. For instance, the Riksbank's role was changed with the introduction of the inflation target and independent monetary policy, but there were also major changes in other areas, such as the introduction of an expenditure ceiling for the government and balance requirements in municipalities and regions in the fiscal policy framework, as well as significant changes in wage formation. This was the result of a failure we had in Sweden and it has functioned exceptionally well. The reforms made at that time have contributed to the 25 years of stability we have had in Sweden. What we are seeing now is a challenge to the regime we have had since the 1990s crisis. Today all of these parts are being challenged; the Riksbank, wage formation and fiscal policy. It is important that the Riksbank does its part, and ensures that monetary policy can bring Sweden back to something like the stability we have had for the past 25 years. It is therefore very important to tighten monetary policy now and ensure that inflation falls. If there had been a majority at today's meeting in favour of raising the policy rate by 0.75 percentage points, I would have supported it. However, the policy-rate path entails further hikes going forward, so I will support today's decision. It is very clear to me that monetary policy needs to become much less expansionary.

Deputy Governor Martin Flodén:

I support the proposal to raise the policy rate by half a percentage point to 0.75 per cent, the proposed policy-rate forecast, the draft Monetary Policy Report and the proposal to reduce asset purchases in accordance with Annex B to the minutes.

Since our monetary policy meeting in April, inflation has continued to rise and our forecast for inflation in the near term has once again been revised upwards significantly. Although the price increases can still largely be explained by high energy prices and by higher prices for companies' input goods caused by production and delivery disruptions, the inflation has recently become increasingly broad. There is a notable risk that this development, if it is allowed to continue, will lead to the inflation becoming entrenched at too high a level at which the inflation target will no longer form the basis for price- and wage-setting.

In this situation, monetary policy needs to focus on bringing down inflation towards the target of 2 per cent. Monetary policy therefore needs to be tightened.

The Riksbank's policy rate has been very low ever since it was rapidly reduced in late 2008 in connection with the global financial crisis, and it has not been higher than it is now since autumn 2014. During this period, the economy has changed; economic agents have, for example, become more indebted and may also have begun to consider low interest rates to be a normal situation. It is therefore difficult to assess how the economy and its various agents will react when interest rates now increase.

But this uncertainty does not mean that the Riksbank has to proceed cautiously with rate hikes. It is nevertheless clear that the Riksbank's policy rate will need to be raised considerably from its current level of 0.25 per cent in order to dampen inflation sufficiently. Hiking the rate in the near term increases the chances of us preventing a problematic development in which price- and wage-setting are based on above-target inflation. I therefore think that the proposal to increase the policy rate by half a percentage point is good. It is also positive that our forecast for the policy rate indicates that we will continue to raise the rate in the autumn.

Both the higher policy rate and the high inflation will dampen households' purchasing power, and this is already starting to emerge in various indicators. For example, Swedish households are now unusually pessimistic in the National Institute of Economic Research's economic tendency survey and both retail sales and housing prices seem to have started to fall. Compared with the Monetary Policy Report in April, our forecasts for GDP- and consumption growth have been revised significantly downwards. I see this as a necessary development. As inflationary pressures appear to be higher than we assessed earlier, tighter monetary policy is required to further dampen economic activity so that inflation falls back.

We should also remember that the initial position is strong with high employment and a resource utilisation that is high in many parts of the economy. Many companies are reporting high profitability and recently seem to have had ample opportunity to increase the price of their goods and services. That monetary policy then needs to be tightened when inflation is far above the target is fairly obvious.

Our forecast is that this tightening will only lead to a mild economic slowdown, and that inflation will still fall back rapidly next year. This is an optimistic scenario, and I want to stress that our focus needs to be on bringing down inflation even if this would lead to, or require, even weaker economic developments in the near term. The alternative – that inflation is allowed to stay far above the target for an even longer time – risks leading to a loss of confidence in the inflation target and monetary policy. This would in turn cause serious problems for economic developments in the longer run.

We therefore need to raise the policy rate now and probably continue to increase it rapidly at our meetings in the autumn. But it is difficult today to judge how the policy rate needs to develop after the monetary policy meetings immediately ahead. As I said to begin with, it is not only difficult to determine how the economy will be affected by interest-rate changes but also uncertain how price- and wage-setting will be affected both by subdued economic activity and by the price increases we have already seen.

This uncertainty means that our monetary policy needs to be continuously reviewed. Our forecasts for future monetary policy – including the forecasts for the immediate future – are exactly that, forecasts and not promises. The important message today is that the interest rate needs to be raised rapidly in the near term and that going forward we will need to adapt monetary policy to new information on the impact of our rate hikes and on how inflation is developing.

Finally, I would like to say a few words about the asset purchases. At several previous monetary policy meetings, I have wanted to see a faster tapering of the purchases. The reasons for tapering the purchases are reinforced by inflation having continued to rise rapidly. It is therefore positive that we are now deciding on purchases at a slower pace than the earlier plan and that our holdings will therefore decrease faster than we previously planned. I however believe that we could have ended purchases of corporate bonds immediately and other purchases after the third quarter of this year without any problems, but since the proposal again involves a significant tapering, I do support it.

Deputy Governor Per Jansson:

I would like to begin by saying that I support the economic assessments and the monetary policy assumptions in the draft Monetary Policy Report.

Since our last monetary policy meeting at the end of April, inflation has continued to rise sharply, in an increasingly worrying fashion. The latest inflation outcome, which is for May, came in at 7.2 per cent. At our April meeting, when we had access to outcomes up to and including March, inflation was just above 6 per cent and our forecast at that time was that it had more or less peaked. That inflation has continued to be much higher than expected is obviously a cause for concern. But even more worrying is that the breadth of price rises has increased further. The median of our measures of underlying inflation, which this time corresponds to CPIF inflation excluding energy, now stands at 5.4 per cent, compared to 4.3 per cent in connection with the meeting in April. Of the seven measures that we regularly update, six now exceed 5 per cent and the lowest measure is only a few tenths of a percentage point below 5 per cent.

The larger breadth of price increases is also clearly evident from the various sub-components of inflation, where the only component that has not shown a higher price growth since March is energy prices. Among the various sub-components, it is above all the acceleration in the rate of increase in food prices that sticks out compared to March. Considering the contribution to the rise in inflation, where the weight of the sub-components in the consumption basket also plays a part, it is now service prices that are affecting overall price growth the most.

At our last meeting, I noted that a broad and more general price increase means that the first line of defence against more persistently high inflation has been breached. Furthermore, I pointed out that the next stage is then a question of preventing the currently broad upturn in prices from being expected to persist for a long time to come, that is, ensuring that longer-term inflation expectations do not rise. If these were to start to rise, the risk of compensatory wage increases would go up, which in turn could create a further need for price hikes, followed by even higher demands for wage increases, more price hikes, and so on. In all, we would then have a price- and wage-setting that is not compatible with the inflation target.

But I also said that not every tendency towards higher wage growth has to be problematic and part of a price-wage spiral. If wages in the years to come now rise slightly more rapidly than previously, which in fact they are assumed to do in our forecast, it will not be a problem as long as there is still fundamentally confidence in inflation returning to the target. Annual wage growth in the whole economy of around 3–3.5 per cent is actually more compatible with an inflation target of 2 per cent than the growth of 2–2.5 per cent we have had over the last ten years or so.

Regarding Prospera's new measurements of longer-term inflation expectations, the results are both pleasing and somewhat surprising. The new information consists of the monthly survey for May, which only covers money market participants, and the larger quarterly survey for June, which among others also measures the expectations of the labour market organisations.

In the May survey, the five-year inflation expectations of money market participants increased relatively sharply, from 2.2 per cent in the previous survey in April to 2.4 per cent.[4] But they then fell back again in the June survey, to just under 2.3 per cent. This fall was obviously not substantial but still very welcome and pleasing. I myself saw that there was some considerable risk of these expectations continuing to rise rapidly in June as well. It is important to note here

[4] 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.

that the very bad inflation outcome for May had not yet been published when the survey in June was conducted. But even the April outcome for inflation was very high, so I still think that this is good news, at least for the time being.

It is also very positive that the long-term expectations of the labour market organisations continue to be stable and concordant. For both the employee and employer organisations, these remain in June on the same level as in the previous quarterly survey in March, 2.2 per cent. After many years with inflation below 2 per cent and signs that the inflation target is not really fulfilling its role as long-term nominal anchor, I do not think it is a cause for concern that these expectations marginally exceed the target and neither do I interpret this as a sign of a lack of confidence in the Riksbank succeeding to return inflation to 2 per cent within a reasonable time perspective.[5]

The longer-term inflation expectations estimated from the market pricing of financial contracts continue in general to be higher than the survey-based expectations on corresponding time horizons. But as these vary considerably over time and are difficult to interpret as pure measures of inflation expectations, I continue, as before, to attach less importance to them.

My conclusion regarding the longer-term inflation expectations is therefore the same as in April; the second line of defence against more persistently high inflation has not been breached. And my thoughts on suitable monetary policy going forward also continue to be focused to a very high degree on designing it to ensure that this line of defence remains intact.

So far, it no doubt sounds as though the situation has not changed very much since our meeting in April. Inflation is high and the price increase broad but the longer-term inflation expectations indicate confidence in us managing to return inflation to the target. Wage increases also continue to be very moderate, 2.1 per cent according to the most recent outcome for March. At the same time, various union representatives have continued to stress that forthcoming wage negotiations will be facilitated if the social partners know that the Riksbank is doing what it can to bring inflation back down to 2 per cent. Such statements are pleasing and indicate a wish to act responsibly in wage formation. For this, I think they deserve respect and praise.

But what I find increasingly worrying, and in this respect the situation has also deteriorated since April, is the change in price-setting behaviour among Swedish companies. I mentioned earlier that the largest contribution to the increase in inflation between March and May is now coming from higher service prices. Companies that have been hard-hit by sharply rising costs due to the pandemic and Russia’s invasion of Ukraine, and perhaps also were in a relatively difficult

[5] The five-year expectations for CPIF inflation are furthermore slightly lower, 2.0 per cent for the employer organisations and 2.1 per cent for the employee organisations.

profitability situation to begin with, may obviously have a need to adjust their sales prices upwards. But if they instead have a cost structure that is more independent of these factors and circumstances, I have significantly less understanding for such price-setting behaviour in this difficult situation for the Swedish economy. It obviously provides particular food for thought when various industries in the business sector themselves report in the Tendency Surveys of the National Institute of Economic Research that their profitability is now unusually high and also has been so for some time.[6]

It is perhaps worth emphasising that the appeal to companies to think carefully about their price-setting behaviour is not a question of them starting to turn a blind eye to their profit interests and instead start acting based on some kind of public kindness. With the point of departure that the Riksbank will do what is required to achieve the inflation target within a reasonable time perspective, it is all about how high and persistent inflation needs to become and how large rate hikes will then be necessary to bring inflation back down to the target. If it even goes as far as companies' price rises eventually bringing on larger compensatory wage increases, it may become a question of very large policy-rate hikes by the Riksbank, and even with such rate hikes, inflation risks in this case remaining on a high level for longer than otherwise. Such an outcome is obviously not good for anyone, not for Swedish companies either.

The draft Monetary Policy Report proposes a significant upward revision of the forecast for inflation up until the summer of next year. Inflation is now expected to peak at 8 per cent, in June, October and November this year. The forecast for inflation excluding energy prices is also sharply revised upwards in approximately the same time perspective. Energy prices excluded, price increases are expected to peak at 6.4 per cent in December this year. The background to the large upward revisions of the forecasts is that inflation has continued to rise unexpectedly rapidly and that the price increase is spreading increasingly in the economy. In addition, the rate of increase in energy prices has surprised on the upside, which explains why the forecast for total inflation has been adjusted upwards more than the assessment for inflation excluding energy prices. In the second half of 2023, the forecasts for inflation both including and excluding energy prices gradually approach the previous assessments from April. Around the turn of the year 2023–24, inflation is only marginally higher than in the April assessment and in line with the inflation target.

That inflation is in line with the target in the same time perspective as in April is due to monetary policy now being tightened faster and more than before. In this situation, it is key to react early to poorer inflation prospects, so the interest rate is higher especially in the near term, including a

[6] For a more detailed reasoning about this and other aspects related to the broad increase in inflation, see the article "Price rises are spreading in the economy" in the draft Monetary Policy Report.

so-called double hike already at today's monetary policy meeting. For my part, I will continue to be guided by the rule that inflation shall be very close to the target around the turn of the year 2023–24. This gives wage formation stable prerequisites, with inflation back at the target well within the time period during which forthcoming wage agreements can be expected to apply.

Despite that we now feel compelled to increase the interest rate faster and more than we thought in April, the real policy rate is negative for almost the entire period for which it is possible to calculate it.[7] In this sense, the rate increase during the forecast period is still rather modest. It is important to stress that this monetary policy will only be compatible with a return of inflation to the target as from 2024 if confidence in the inflation target remains and this continues to be reflected in wage increases. Companies with no major need to increase their prices but that nevertheless take the opportunity to do so is in this context not helpful and will, if it continues, make it increasingly difficult to maintain a responsible wage formation. Let us hope that our companies realise this and play their part in helping to avoid severe monetary policy tightening and even more serious inflation problems.

First Deputy Governor Cecilia Skingsley:

As this is my last ordinary monetary policy meeting, I would like to begin my contribution by thanking the staff at the Riksbank and my colleagues on the Executive Board for good teamwork during my years here. For a long time, the Riksbank used to print its motto, *Hinc robur et securitas* (herefore strength and safety), on the banknotes. It was removed a long time ago, but people at this workplace still work according to this motto. It has been an honour to count you all as my colleagues.

I support the draft Monetary Policy Report and the proposal to change the policy rate and the proposal for amending the asset purchases in accordance with Annex B to the minutes.

"The inflation target is now being put to the test," as Governor Stefan Ingves concluded his contribution to the previous monetary policy meeting on 27 April. This is true. Inflation has continued to rise and price increases have spread throughout the economy. The mandate given to the Executive Board by the legislator is clear: to safeguard price stability measured in SEK. In light of the deterioration in inflation prospects, monetary policy needs to continue to be tightened to bring inflation back to the target and stabilise it there. Policy rate increases and the reduction of previously acquired assets will slow down continued price-raising behaviour and

[7] For technical reasons, the real policy rate can only be calculated up to and including the second quarter of 2024, see Figure 10 in the draft Monetary Policy Report.

reduce the risk of a price and wage spiral. Large hikes in the near term also reduce the risk of needing to increase the level much more later on to break such a spiral.

In my previous contribution to the minutes I talked about the difficulty of predicting the strength of the recent upturn in inflation. The Riksbank's models were not able to predict the upturn and no other forecaster published forecasts indicating what we are now assuming, that inflation will be above 7 per cent for the remainder of 2022. The configuration of the recovery from the pandemic with its increase in demand and supply shocks, followed by the commodity price shock after Russia invaded Ukraine, was too difficult to capture in advance. Over time we will gain more knowledge. Some observations need to be taken into account in future forecasting work.

The first observation is that energy price changes under certain circumstances have severe spillover effects on prices of other goods and services. The cost change is particularly important for the production of food. Energy and food, goods that households have difficulty doing without, are large items in the CPIF and the general perception of higher prices is therefore strong, and is driving households' inflation expectations.

The second observation is that unexpectedly large international price increases could be discerned as early as last year. At the Riksbank we should have asked ourselves earlier whether the price pass-through to Swedish goods and services might not be greater than we assessed a couple of months ago.

The third observation is that in a low-inflation environment, which has dominated large parts of the world for more than a decade, companies have had difficulty in compensating themselves for their own cost increases and have therefore preferred to vary their profitability rather than lose market shares. However, pandemic-related shocks and Russia’s invasion of Ukraine have broken this pattern. Acceptance of price increases has now broadened in many and large sectors of the economy. Understanding the driving forces behind this type of shift will be important knowledge for the future. Here I would like to agree with what Per Jansson just said about assessments of company profitability. I am also concerned that the price increases are now also taking place in sectors where the underlying cost pressures have not manifestly risen.

The new policy-rate path means that the Riksbank’s policy rate is expected to rise to just over 2 per cent in the coming three years. In real terms, however, the policy rate is still negative for almost the entire forecast period.

It is difficult to know whether this is enough to bring inflation back to target, or whether we need more, or less. The risk section in Chapter 1 of the draft Monetary Policy Report refers to what we internally refer to as the ‘fan’ around the forecast for the future policy rate. I would like to point out that I see a major risk of less favourable international developments than is stated in the forecasts and that problems may spread to Sweden. It is not only the Swedish economy that has become used to low inflation. Low interest rates and growing indebtedness have been a global theme for a long time now. As the interest rate environment changes, the risk of payment defaults and other shocks that can hold back global economic activity going forward increases. If the geopolitical tensions worsen, financial conditions are tightened more than expected and globally priced goods continue to rise in price, the result will not be beneficial to an open and trade-dependent economy like Sweden's. One positive factor, however, is that Sweden has fiscal policy scope to counteract poor economic development, but finding the right combination of measures will be difficult in both economic and political terms.

The monetary policy tightening shall be implemented, as far as possible, without slowing down economic activity too much and while retaining financial stability. But if these objectives come into conflict with one another, it is the stabilising of inflation and financial stability that must take precedence over economic activity. Without monetary and financial stability there are no conditions for good economic development, quite the reverse.

During the years with low interest rates to attain the price stability target, the Riksbank has repeatedly discussed and pointed out that its own monetary policy needs to be combined with measures to reduce vulnerabilities that could trigger financial instability. Not least Governor Stefan Ingves has repeatedly warned that interest rates will not remain low for ever. It is not likely that a mortgage with a maturity of 40, 50 or perhaps 60 years will have an interest rate of 1.5 per cent the whole time.

Both Swedish authorities and international analysts have pointed out that the build-up of debt in the household sector is the largest risk in the Swedish economy. Finansinspektionen, which has the responsibility for macroprudential policy in Sweden, has with the aid of, for instance, mortgage caps, amortisation requirements and special risk weights for mortgages endeavoured to strengthen households' capacity to manage a more troublesome macroeconomic development than that which has dominated the 2010s and start of the 2020s. Finansinspektionen's decisions have often been received with intense criticism, but they have nevertheless stood firm. This inspires respect.

Higher interest rates during the entire forecast period will test not only the inflation target, but also how well the macroprudential policy framework functions in Sweden. If the macroprudential policy measures have been sufficiently powerful, households on an aggregate level will be able to manage the coming years with higher interest rates. If not, there is a risk of several difficult conflicting objectives arising in economic policy in Sweden going forward.

Governor Stefan Ingves:

I would like to begin by saying that I support the forecasts and assessments in the draft Monetary Policy Report. Once again, the inflation outcomes have unfortunately been higher than we expected, and the inflation forecast is revised upwards. To ensure inflation returns to the target of two per cent in the medium term, we need to withdraw the monetary policy stimulus at a faster pace than was assumed at the last monetary policy meeting in April. This means that I support the proposal at today's meeting to increase the policy rate by 0.50 percentage points to 0.75 per cent. I also consider the policy-rate path – which implies further policy-rate increases during the rest of this year and some way into next year – to be a reasonable forecast. At today's meeting, we are also making the decision to taper the Riksbank's asset purchases during the second half of the year more rapidly than we decided earlier. This means that our balance sheet will shrink slightly faster than in our previous forecast. Overall, these measures imply a monetary policy focused on preventing the high rate of inflation from continuing and instead bringing it back down to two per cent during the forecast period, and maintaining confidence in the inflation target. There must be no doubt about our determination to return inflation to our target of two per cent.

2022 is far from over, but can already be described as a dramatic year. At the beginning of the year, most analysts probably saw the pandemic as the primary source of uncertainty and risk in the economy. The pandemic is still casting a shadow over economic developments, perhaps primarily in China and in the form of recurring periods of supplier problems and bottlenecks in production. But compared to 2020 and 2021, the situation as regards the pandemic is much more stable on the whole. In many parts of the world, we have, so to speak, learnt to live with the pandemic and the effects on economic activity are not as significant as before.

The drama and uncertainty are now more connected with Russia's continued warfare against Ukraine. The human costs of the war are horrifying and the economic consequences unforeseeable. It will take decades to rebuild what is now being destroyed at a rapid rate – the trust between countries in the region in particular, but also economic and social infrastructure. Recent news reporting from Ukraine does not suggest that the war is likely to end any time soon. In our forecast, we assume that the supply disruptions caused by the war and the pandemic will continue for the rest of the year. But in my view, there is a risk that 2023 will also be characterised by major shocks in the global economy.

Our forecast for growth abroad as a whole, KIX-weighted, has been revised down as a result of the war in Ukraine, recurrent lockdowns in China and lower purchasing power among households in the wake of higher inflation. But global economic growth as a whole nevertheless remains reasonable. Global KIX-weighted growth is expected to be 2.7 per cent this year and slightly lower in the coming years.

Our forecast for KIX-weighted inflation this year has been revised up to 7 per cent. In several parts of the world, inflation is now higher than for several decades. What began last year as price rises in certain sectors has now this year spread and become a broad increase in inflation. Many central banks have adjusted monetary policy in a more restrictive direction, although the pace of the tightening varies. As the monetary policy measures take effect, KIX-weighted inflation is expected to fall back to just above 2 per cent at the end of the forecast period.

The war in Ukraine has had an indirect impact on economic developments in Sweden. This, together with rising interest rates and global growth being expected to be modest in the coming years, is dampening Swedish GDP growth. For this year, we are expecting GDP to grow by just under 2 per cent, and then to slow down to around 1 per cent on average in 2023 and 2024. But the Swedish economy is nevertheless in reasonably good shape. The employment rate is at a historically high level, although it will fall somewhat going forward. There are plenty of job openings and labour shortages are at record levels.

Since the previous monetary policy meeting in April, we have received two new inflation outcomes, and both have been higher than our forecasts from the monetary policy report in April. The most recent outcome, CPIF inflation in May, was 7.2 per cent, which was almost one percentage point higher than our old forecast. CPIF inflation excluding energy also surprised on the upside and in May came in at 5.4 per cent. The annual average for the CPIF is expected to be 6.9 per cent this year, 4.2 per cent in 2023 and 2.0 per cent in 2024.

There are several reasons why inflation is expected to fall back towards the end of the forecast period. The high inflation this year is due to many prices having risen over the past year, which may sound a little trivial. But the point is that prices must continue to rise at the same high pace in the coming years in order for the inflation rate not to fall. New, large and rapid further price increases are not so likely, as long as we do not see new major supply shocks in the global economy. So, all else equal, the inflation rate should fall in the years ahead. But inflation can be boosted from secondary effects as well, i.e. price increases in one category or industry spill over to other areas, including the labour market. This is the kind of spillover effect that monetary policy can offset. By raising the interest rate and signalling our preparedness to do what is required for inflation to fall back to the target, we create conditions for the inflation target to continue to be an anchor for price- and wage-setting in the Swedish economy.

As a forecaster, the Riksbank has had a bad year so far. Figure 4 in the draft Monetary Policy Report gives a breakdown of the forecast errors. We can see in the figure that a large share of the surprising increase in inflation from the start was due to rising energy prices. But recently, especially this year, other components in the CPI have also surprised on the upside; goods, food and service prices have risen more than in the forecast. For the Riksbank, of course, the understanding of inflation and its driving forces are a central element of the monetary policy analysis, and extra resources and new analytical methods have been employed. With higher inflation, volatility in the inflation rate can also increase, making forecasting more difficult. Like other central banks, the Riksbank will need to continue to develop forecasting and analytical methods to capture the increased volatility and many other things that are now occurring.

After a long period of too low inflation and low interest rates, western economies seem to have moved into a new phase. To counteract the high inflation and to safeguard credibility in a monetary policy focused on price stability, most central banks in the western world are now in a rate-hike cycle. The age of low interest rates seems to be over. An important issue in the coming years is how the financial sector, companies and households adjust to higher interest rates. A central question is the households' interest-rate sensitivity, and how the monetary policy transmission mechanism is affected by higher indebtedness among households and companies. New risks will probably arise when highly leveraged activities are to be adapted to new funding conditions. Bringing inflation under control will not be painless.

The financial and economic landscape looks different now compared to, say, twenty to thirty years ago. This is one reason for all the new tools used by central banks to support the transmission mechanism and safeguard confidence in the inflation target. As I mentioned to begin with, the Riksbank's balance sheet will shrink in the period ahead. But in my view, this should not go too far. The Riksbank will also need to have a portfolio of assets in the future to ensure that there is sufficient capacity and knowledge in order to take necessary monetary policy measures if need be. The world is unpredictable.

In conclusion, we have been surprised during the year by an increasingly high inflation rate. The Riksbank changed course rapidly at the last monetary policy meeting in April and raised the policy rate and the rate path. Since then, we have received two inflation outcomes over forecast, and at today's meeting we are increasing the pace of rate rises. We are doing this to ensure that this year's high inflation outcomes do not become persistent, with the risk of secondary effects on price- and wage-setting. We are fully focused on safeguarding confidence in the Swedish inflation target. At the same time, I am not sure that an interest-rate level of two per cent is enough to bring inflation down to our target. Given the present uncertainty, a time horizon up to the turn of the year is about right but, if it is needed later on, more hikes are reasonable if that is what it takes to achieve our target.

Concluding comments

Henry Ohlsson added that over the past few years it has not always been the case that he and Per Jansson have shared the same views on monetary policy, but on this occasion he agrees with a lot of what Mr Jansson has said.

The meeting concluded with Governor **Stefan Ingves** thanking Cecilia Skingsley: Cecilia, many thanks for all your efforts at the Riksbank over many years. One couldn't have a better colleague than you, you have never faltered when times have been difficult and you have served the Riksbank well. I wish you the best of luck now that your horizons are broadening and you take to the global stage.

The other Executive Board members joined Stefan in his good luck wishes.

§4. Monetary policy decision

The Executive Board decided

- to increase the policy rate to 0.75 per cent and that this decision apply from Wednesday 6 July 2022,
- to establish the Monetary Policy Report according to the proposal, Annex A to the minutes Monetary Policy Report,
- on monetary policy measures and that these measures be applied in accordance with what is stated in Annex B to the minutes, the Riksbank's bond purchases in the second half of 2022,
- to publish the monetary policy decision with the motivation for it in a press release on Thursday 30 June 2022 at 09.30,
- to publish the minutes from today's meeting at 09.30 on Monday 11 July 2022.

This paragraph was verified immediately.

Minutes taken by:

Paul Elger Christina Håkanson

Verified by:

Stefan Ingves Cecilia Skingsley Anna Breman

Martin Flodén Per Jansson Henry Ohlsson

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