Monetary policy minutes

September 2023

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

Summary

For inflation to fall back and stabilise around the target of 2 per cent within a reasonable time, the Executive Board decided at their monetary policy meeting on 20 September to raise the policy rate by 0.25 percentage points to 4 per cent. The forecast for the policy rate shows that it may be raised further.

The members noted that although inflation is on the way down, in line with the Riksbank's assessment in June, inflationary pressures are still too high. The fall in inflation is largely due to a sharp decline in energy prices since last year. Excluding energy prices, annualised inflation is falling back more slowly. Also, when measured over shorter periods, such as month to month or quarter to quarter, prices are increasing at a rate that is not compatible with the inflation target.

The members emphasised the risks associated with the continued high underlying inflation and the weak krona. To ensure that inflation continues to fall and stabilise around the inflation target within a reasonable time, the Executive Board considered it appropriate to tighten monetary policy somewhat further and raise the policy rate from 3.75 to 4 per cent.

The Executive Board also assessed that the policy rate may need to be increased further. New information and how it is expected to affect the economic outlook and inflation prospects will be decisive in determining the monetary policy stance, but the members pointed out that monetary policy will need to be contractionary for a significant time going forward.

MONETARY POLICY MINUTES

Executive Board, No. 4

DATE:	20 September 2023
TIME:	09:00
INFORMATION CLASS:	OPEN
PRESENT:	Erik Thedéen, Chair Anna Breman Aino Bunge Martin Flodén Per Jansson --- Bo Broman, Chair, General Council of the Riksbank Tomas Eneroth, Vice Chair, General Council of the Riksbank --- Lena Arfalk Charlotta Edler Bul Ekici Mattias Erlandsson Peter Gustafsson Anders Gånge Marie Hesselman Christina Håkanson Jens Iversen Magnus Jonsson Anders Kvist Pernilla Meyersson Ann-Leena Mikiver Marianne Nessén Åsa Olli Segendorf Olof Sandstedt Maria Sjödin Ulrika Söderberg --- Joel Birging (§1–3a) Maria Johansson (§1–3a)

It was noted that Bul Ekici and Magnus Jonsson would prepare the draft minutes of the monetary policy meeting.

§3 a. Economic developments

Market developments since the last monetary policy meeting

Joel Birging from the Markets Department began by presenting the latest developments in the financial markets. Since the monetary policy decision in June, central banks in several developed economies have continued with policy rate increases, which, among other consequences, have led to higher government bond yields. It is primarily increases in government bond yields with longer maturities that have gained attention. This development has been mostly driven by US government bond yields. The combination of expectations of policy rates remaining high for a longer period, better-than-expected economic statistics from the United States, the downgrading of the US government's rating and an increased supply of US government bonds has contributed to the higher government bond yields. Another driving force behind the yield increase is rising oil prices. Brent Oil is at its highest levels this year as a result of Saudi Arabia having extended its production cuts at the same time as global demand is expected to rise in the coming months. The yield increase in Europe is partly due to greater concern over continued high inflation.

In foreign exchange markets, the US dollar has strengthened on a broad front supported by higher US interest rates and relatively positive growth prospects. In equity markets, the development has been divided, with clear increases in the United States driven by large tech shares, while European stock market indices, including the Swedish index, have performed less well. In China, stock market indices have fallen further to their lowest levels this year due to concern over economic setbacks, for example in light of highly leveraged real estate companies and so-called shadow banks.

The krona has depreciated recently and reached record-low levels against the euro. The weak krona and continued high inflation are strong arguments for continued tightening according to analysts. Expectations according to both forward rates and forecasts indicate an increase of 0.25 percentage points in September and probability of another increase in November.

Financial stability - current status and risks

Olof Sandstedt, Head of the Financial Stability Department, described the situation in the Swedish financial system. The high inflation and higher interest rates are challenging the stability of the global financial system and risks are elevated.

The Swedish financial system is functioning well for the most part and the major Swedish banks are considered to have a healthy initial position, although the vulnerabilities to which the Riksbank has alluded for a long time pose challenges. These primarily concern the highly indebted real estate companies and the banks' substantial exposures to this sector, as well as the large loans of Swedish households. In addition, experience from the banking turmoil in the spring shows that banks can encounter problems with liquidity even when they fulfil the regulatory requirements. The Riksbank therefore considers that the major banks should strive for significant margins over and above the capital and liquidity requirements.

The higher interest rates are posing a challenge to the ability of real estate companies to service their debt and are also contributing to a decline in the value of properties. But there are significant differences between real estate companies, with some better placed to cope with higher interest rates. Even if a few real estate companies have recently issued bonds, many continue to finance loan maturities primarily through increased bank loans from Nordic banks. To reduce the risk of a negative course of events in the real estate sector, the banks therefore continue to have an important role by imposing demands that measures are taken while also maintaining credit supply to robust companies. Real estate companies are taking measures, but need to do more.

The high costs are squeezing the margins and resilience of households, which can be seen in the form of reduced consumption and saving. Short interest-rate fixation periods make households sensitive to changes in interest rates. Since 2022, just over two-thirds of mortgages have been affected by at least some part of the rate rises in the form of higher mortgage rates. The vast majority of mortgagors are expected to be able to fulfil their debt payments, but individual households may have problems. Overall, housing prices have fallen by just over 11 per cent since the peak in March 2022. In individual months, however, prices have increased.

Rising interest rates and uncertain growth prospects can also affect attitudes to risky assets, such as corporate bonds, in the period ahead. Swedish corporate bond funds therefore remain vulnerable to large outflows if risk appetite suddenly changes.

The current monetary policy drafting process – new data and forecasts

Peter Gustafsson, Adviser at the Monetary Policy Department, presented the current assessment of macroeconomic developments and the proposal for a monetary policy decision that the Monetary Policy Department judged would gain majority support in the Executive Board at today's meeting. The background material for today's decision was discussed with the Executive Board at meetings on 23 August, 5, 6 and 7 September. The draft Monetary Policy Report was discussed and tabled at a meeting of the Executive Board on 14 September.

The drafting prior to today's meeting has focus in particular on the development of inflation and interest rates abroad and in Sweden, the significant depreciation in the krona over the past year, which was discussed in an article in the draft report, and the economic prospects globally and in Sweden.

The general picture of developments have not changed significantly since the decision in June. In light of last year's rapid policy rate increases and that many of the factors that drove up inflation in 2021 and 2022, such as disruptions in energy markets, are now subsiding more and more significantly, inflation is falling back both abroad and in Sweden. However, inflation is still very high in many countries, especially if energy price developments are excluded. Service prices continue to increase rapidly, while the rate of increase in energy and food prices has slowed significantly.

Weaker industrial activity has contributed to a somewhat worse economic outlook in, for example, the euro area over the summer. However, this is assessed to be largely consistent with the forecast in June. A slowdown in economic activity is expected during the second half of the year in the euro area and towards the end of the year in the United States, as the contractionary monetary policy gradually has a greater impact and when demand in the manufacturing sector softens. This means that the pressure in the labour market will ease and wage increases, that are initially high in several countries, will fall back. In 2024 and 2025 inflation abroad is expected to be roughly in line with central bank inflation targets.

In Sweden, the labour market has remained resilient but the signs of a slowdown are now clearer, which is confirmed by the weak outcomes in today's Labour Market Surveys, falling Swedish GDP during the second quarter and confidence indicators that remain subdued for both households and companies. Indicators also suggest that demand in the manufacturing sector is also softening. Although wage increases negotiated in wage agreements in the Swedish labour market were historically high, wage growth is relatively low in a European perspective. The conditions are therefore set for a decline in inflation without unemployment necessarily rising sharply, although employment is expected to decrease somewhat in the wake of softer demand.

The krona has depreciated somewhat further to historically weak levels since the monetary policy meeting in June. The weak krona is sustaining price increases in imported goods and there is still considerable uncertainty regarding its development going forward and what impact the depreciation is having on inflation, something which was discussed in the Monetary Policy Report in June.

CPIF inflation continues to fall and amounted to 4.7 per cent in August. However, underlying CPIF inflation excluding energy is higher and declining at a slower rate.

During the summer months, underlying inflation fell slightly less than in the forecast from June. However, the overall picture is still that inflation will fall back relatively quickly over the next year, which is supported by developments in higher-frequency measures of changes in consumer prices and a number of indicators presented in the draft report. Inflation is expected to be close to target during the second half of 2024, but alternative scenarios in Chapter 1 of the draft report illustrate that the forecast is uncertain.

The draft forecast is based on the proposal for monetary policy described in detail in Annex A to the minutes and which the Monetary Policy Department judges will gain a majority in the Executive Board at today's meeting. The proposal means that the policy rate will be raised by 0.25 percentage points to 4 per cent. The draft forecast is for the policy rate to remain at a level somewhat over 4 per cent for a while and cuts will begin only when underlying inflation has fallen back and been close to the target for a time. At the end of the forecast period, the policy rate is expected to be just under 3.7 per cent. At the same time, the Riksbank's asset holdings will continue to decline through maturities and through the sales of government bonds decided on in June.

§3b. The economic situation and monetary policy

Deputy Governor Martin Flodén:

I support the proposal to raise the policy rate by 0.25 percentage points to 4 per cent and I also support the forecasts in the draft Monetary Policy Report, including the forecast for the policy rate.

At the monetary policy meeting in June I emphasised that the economic outlook was particularly difficult to assess. The new information after the meeting has nevertheless been in line with the forecast we made then, and I would say that the economic indicators are now a little less divergent. We see a clear slowdown in economic activity, primarily driven by rapidly declining housing investment. Household consumption is also declining, but has nevertheless been surprisingly resilient since the rate increases began. And as before, the labour market has remained strong, with high employment.

Inflation has also developed in line with our forecast from June, which means that it has fallen substantially. This is, of course, welcome. Inflation is moving in the right direction, but we have not yet seen sufficiently clear signs that inflationary pressures will actually fall back the whole way to what is compatible with the inflation target.

In light of this, I consider that the policy rate needs to be raised today, in line with what we indicated at the previous monetary policy meeting.

The forecast indicates that the policy rate may, after today's increase, have come up to a sufficiently contractionary level for inflation to fall back towards the target. But this assumes that monetary policy will remain tight for a fairly long time to come. This also assumes that we will receive continued support for the assessment that inflationary pressures will continue to ease. The forecast therefore also shows that it is not improbable that the rate may need to be raised further at one of the coming meetings. All of these are assessments that have my full support.

I will in some detail discuss some of the indicators and data outcomes that I am now following closely and that can be decisive for whether or not further rate increases are needed.

Prior to the next monetary policy meeting we will receive inflation outcomes for September and October. Our forecast is that inflation will then continue falling so that when measured as the CPIF excluding energy it will be just below 6 per cent in October. As I pointed out at the monetary policy meeting in June, the monthly price changes for various sub-indices are now particularly important when I examine the inflation outcomes. However, interpreting the monthly rates is difficult, partly because there are very large, and variable, seasonal fluctuations in the prices of several goods and services.

A further complication when we now examine the inflation outcomes is the large changes in household consumption patterns during and after the pandemic. This means that some inflation figures have been affected quite considerably by changed weights rather than by new price increases. Examples of this include the contribution to service price inflation from recreation and foreign travel, where the weights in the consumption basket are much higher this year than they were last year. The significance of this problem is illustrated in the right-hand panel in Figure 31 of the draft report, where both the level of inflation and the time sequence are significantly affected by the weights used.

Evaluating the high-frequency movements in the inflation figures is thus associated with several uncertainty factors. Figure 32 in the draft report shows prices for various sub-indices both as an annual change and a monthly change, seasonally adjusted and with unchanged weights in the consumption basket. I see this figure as a helpful tool to illustrate the actual price changes by screening out a number of disruptors.

The development shown in the figure is fairly encouraging. Prices have increased much more slowly in recent months than during 2022 and the start of 2023. But we can also see that prices have continued to increase faster than whats is compatible with the inflation target, and that they are expected to continue to increase a little too quickly for some time to come.

Measured in this way, and contingent on our monetary policy plan, the CPIF excluding energy is expected to increase by on average 3 per cent in annualised terms during September to December this year, and 2.4 per cent during the first half of 2024. Even after today's rate increase, the continued impact of earlier rate increases and the expected economic slowdown, it thus still appears to take some time before inflationary pressures fall back the whole way. And with a less contractionary monetary policy there would be greater opportunities for companies to continue raising prices.

This leads me to another set of indicators I am following carefully, namely with regard to companies' pricing behaviour. During 2022, many companies needed to raise their prices as production and purchasing costs rose. The price increases were driven by supply shocks and delivery problems, at the same time as household demand was high.

A lot of this has now changed. The supply shocks have waned and global commodity prices and freight costs have fallen rapidly. Producer prices have, on the whole, stopped rising and in many cases have instead declined. Given this, companies' price plans should also normalise.

We receive important indicators of companies' pricing plans from the Riksbank's Business Survey and the National Institute of Economic Research's Economic Tendency Survey. The responses there indicate that fewer, but still too many, companies are planning to raise their prices towards consumers.

Finally, I would also like to mention the development of the krona. The continued depreciation of the krona is a worry for monetary policy. It becomes more difficult to bring down inflation when the weak exchange rate contributes to higher import prices. And it is hardly good for the Swedish economy in a broader sense if the krona deviates so significantly from what is assessed to be its long-term equilibrium level. A rate increase today should help slow down the krona's depreciation.

At the same time, the significance of the krona for the Riksbank's capacity to bring down inflation should not be exaggerated. Since the end of 2020, the krona has depreciated by 19 per cent against the euro and 36 per cent against the US dollar. However, the overall price increase, measured in terms of the HICP harmonised price index, is nevertheless lower in Sweden than in the euro area and the United States during this time period. Since December 2020, price levels have risen by 16.5 per cent in Sweden, 18.0 per cent in the euro area and 18.2 per cent in the United States.

The fact that prices have so far risen less in Sweden than other countries since the international upturn in inflation began can be explained to some extent by prices beginning to rise at a later stage here, and in addition it probably takes time before the krona depreciation has full pass-through to our prices. It is nevertheless conceivable that part of the explanation is that monetary policy has had a rapid impact on the interest-sensitive Swedish economy, and that it has therefore been possible to hold inflation back, despite the weak krona. However, if the krona remains at its currently weak level, it will probably require contractionary monetary policy over a long period of time to continue counteracting a pass-through to consumer prices.

To summarise, I consider that the conditions for our monetary policy have developed roughly as we envisaged at the monetary policy meeting in June. The proposal to raise the policy rate to 4 per cent today and the proposed forecast for the policy rate path are also in line with what we indicated in June. I support these proposals.

Deputy Governor Aino Bunge:

I support the assessments and forecasts made in the draft Monetary Policy Report, and I support the proposal to raise the policy rate by 0.25 percentage points to 4 per cent, as well as the interest rate path. The path shows that the policy rate may be raised further and that monetary policy needs to be contractionary for a period.

The effects of the tighter monetary policy are now showing up in the price statistics. Inflation is on its way down, and for our target variable CPIF inflation, the outcome was 4.7 per cent in August, which was close to our forecast from June. At the same time, underlying inflation, measured as CPIF excluding energy, is not falling as fast but was 7.2 per cent, somewhat higher than the June forecast. During the summer, growth has been slightly weaker and the labour market strong, although there are signs of a slowdown. The summer has been eventful for the Swedish krona, and it is now unexpectedly weak. My overall picture is that the development of inflation and the real economy is largely in line with what we saw ahead of us in June.

When we look further ahead, we see that inflation, with the planned monetary policy tightening, will continue to fall during the autumn and be close to the target next year. As shown in the draft Monetary Policy Report, there are risks linked to this forecast, both with regard to the global economy and to the Swedish economy. Here I would like to discuss in more detail the need for, as well as the difficulties in, making international comparisons.

The rapid downturn in Swedish CPIF inflation is to a great extent linked to the fall in energy prices. They are now firmly contributing to the downward impact on inflation, as Figure 5 in the draft report clearly shows. Things look fairly different in the EU, and this is partly due to the design of the energy support undertaken by European governments during last year's energy crisis. My view is that in the current special situation, it is even more difficult to compare inflationary pressures between countries when energy prices are included. Here, too, focusing on inflation excluding energy is justified. There we do not see the same rapid decrease; in many countries within the EU it is still significantly above 2 per cent.

Figure 5 in the draft report also shows that the largest contribution to inflation in Sweden now comes from service prices. The rate of increase in these prices remains high and is to a very large extent related to domestic factors. It shows the delayed effects of high demand, which has enabled companies to raise their prices. One interesting observation, which can be seen in Figure 31 of the draft report, is that service prices are increasing rapidly in many countries simultaneously. However, this is due to similarities in macroeconomic developments in the wake of the pandemic, where savings increased and there was considerable demand for services once economies reopened.

I also think it is important to note that shorter-term price changes, between months or quarters, are still happening at a rate that is not yet compatible with the inflation target. Personally, I think it is clear that monetary policy still has some work to do with regard to dampen demand so that inflation continues to fall.

The high inflation is very problematic, particularly for households with small margins. It is therefore natural that we have a clear focus on bringing it back to target. However, it is also important that we consider the real economy and conduct a well-balanced monetary policy. Our goal is to bring inflation back to target within a reasonable time, without causing unnecessary harm to the real economy. The first chapter of the draft report describes alternative scenarios for inflation and monetary policy. This shows that if monetary policy reacts too late when inflation is higher than expected, the policy rate may eventually need to be raised much more than if it had reacted earlier. The consequence of such actions could be a weaker real economy in the longer run. We must also consider this insight.

Many central banks around the world have raised their policy rates considerably since the start of last year. The Riksbank and the ECB have raised their policy rates by around the same amount during this period. However, the effects on household finances differ in Sweden compared with some of the economies in the euro area. Swedish households are substantially affected by rising interest rates, because of high debts and short interest rate fixation periods. There is a good illustration of this in a fact box in the draft report (see "The impact of monetary policy on interest-sensitive sectors in a European perspective" in Chapter 2). Mortgage rates in the stock of borrowers have hardly altered in Germany and the

Netherlands, but have risen by a few percentage points in Sweden. In comparison, it is custom in the United States to fix mortgages for 30 years.

As a result of the high sensitivity to interest rates, we have seen a clear downturn in household consumption in Sweden over the past year. However, as shown in an article in the draft report, the large upturn in interest rates was preceded by a very high level of saving during the pandemic (see the article "Household savings increased significantly during the pandemic"). The article shows estimates indicating that households may have some buffers left. A tricky but important question is how households will use these savings. This is in turn linked to how they are distributed, but as the Riksbank has pointed out earlier, there is a lack of microdata in this field. The propensity to use savings is also affected by what people expect to happen with their own finances going forward, not least the risk of unemployment. I agree with the assessment in the draft report that while households have been able to use some of their savings buffers to maintain consumption so far, it is less likely that this will continue, especially if the labour market cools as we expect in our forecast.

And this brings me to the labour market. Both in Sweden and abroad, labour markets have so far withstood the economic slowdown surprisingly well. There are a number of explanations for this that are connected with the lessons from the pandemic. But as wages have increased at a relatively moderate pace, and that it has been possible to raise prices, also plays a role. Labour costs have been kept down, which may have helped to strengthen demand for labour and helped Swedish companies to retain their employees. In an international perspective, wages are still increasing at a slower pace in Sweden and are therefore less of a risk to inflation in the short to medium term. But one important mechanism as far as Sweden is concerned is that weaker development in demand now makes it more difficult for companies to continue raising prices, not least for services.

A factor that is currently making it difficult to stabilise inflation in Sweden compared with a number of other countries, is the weak krona exchange rate. It is probably a combination of many different factors that has weakened the krona. However, there are also strong reasons to assume that it will strengthen eventually (see the article "The krona will strengthen in the medium term" in the draft report). As pointed out in Chapter 1 in the draft report, there is an upside risk to the inflation forecast which comes from two directions: Firstly, the krona may continue to be weaker than expected, and secondly the pass-through to inflation via import prices may be greater.

When it comes to the risks in the Swedish economy, the Riksbank has been pointing to the commercial real estate market for a long time. We can now see that risks in this sector are also being highlighted in other countries, when economic activity slows down and high leveraging is increasingly called into question. There is every reason to also monitor international developments, as there can be spillover risks from both China and the United States that can have a negative effect on global economic activity. At the same time, the analysis needs to be nuanced and take into account the unique national features of the commercial real estate market, just as for the housing market. The fact box in Chapter 2, “The division in the commercial real estate sector,” provides a good illustration of conditions on the Swedish commercial real estate market.

I would now like to move on to my overall assessment of monetary policy. I do not see any need for major changes to the plan from June, which was to raise the policy rate at least one more time this year. I therefore agree that the policy rate should be raised by 0.25 percentage points. It is also reasonable, as the rate path indicates, that the policy rate may be raised further. The way prices have developed in the service sector and the weak krona exchange rate pose a risk that inflation will not fall sufficiently quickly and sufficiently far, which justifies the small upward adjustment in the rate path.

Finally, the proposed decision, which I support, means that no changes will be made with regard to the Riksbank's asset holdings. As the rate of the sales decided in June is now being increased in September, the normalisation of the balance sheet will continue at a good pace.

As usual, I would like to conclude with a look ahead to the next monetary policy meeting. In addition to new statistics, we will then have access to a new business survey. This will hopefully shed new light on some of the issues I have discussed today, for instance, how the demand situation affects companies’ pricing behaviour and how the krona impacts inflation

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Deputy Governor Per Jansson:

At our last monetary policy meeting on 28 June, when we had access to outcomes for inflation up to and including May, CPIF inflation was 6.7 per cent. The latest inflation reading, for August, now has CPIF inflation at 4.7 per cent. The substantial fall in inflation over the summer is welcome, but it is important to point out that the decline was expected and is largely due to significant negative contributions from energy prices. If inflation is instead measured excluding energy prices, the development is considerably slower and also somewhat worse than in our most recent forecast. Stripped of energy prices, the outcome in August amounted to 7.2 per cent, to be compared with 8.2 per cent in May and an expected development of 6.9 per cent according to the report in June.

That inflationary pressures continue to be far too high is also highlighted by our measures of underlying inflation. The median of these measures in August was 6.3 per cent, compared with 7.6 per cent in the calculation at our last meeting using data up until the end of May. Here, too, the development is thus rather slow, with a decline during the summer months that is approximately of the same magnitude as for inflation stripped of energy prices.

The inflation figures I have so far mentioned are measured in annual percentage change terms, which is the way we often report and discuss the development of inflation. However, it can also be informative, especially after a period of substantial shocks to the price level, to measure inflation over a shorter period than the last twelve months. This has recently been pointed out by a few monetary policy commentators[1] and is naturally something the Riksbank has also diligently done in recent times, when the price shocks have been unusually large.[2]

A problem with higher-frequency inflation measures, however, is that they are very volatile and need to be seasonally adjusted so that they can be interpreted in a meaningful way. The outcomes we ultimately obtain depend, among other things, on the method used for seasonal adjustment and on how the method is then exactly applied, for example, on which particular data period. An additional complication is that the entire history of outcomes is rewritten when a new outcome is added and the seasonally adjustment is redone. All in all, this means that these measures of inflation must be interpreted with considerable caution.

Despite these difficulties, however, higher-frequency measures of inflation can be informative and the draft Monetary Policy Report also this time presents a number of calculations of this type.[3] The commentators I just mentioned argue that these measures indicate that the problem of excessively high inflation has now actually been solved – and perhaps had been already solved some time ago – without the Riksbank really having realised it.

However, it is very clear that the figures presented in the draft report do not support this conclusion. The measures are indeed moving in the right direction, but they remain on far too high levels that are not compatible with the inflation target. Another important point that is clearly evident is the high volatility of the measures and that, in many cases, it is still difficult to see any obvious downward trends. This applies to both smoothed three-month changes and normal monthly

[1] See K. Eklund (2023), "Räntehöjning är ingen självklarhet" [A rate rise is not a foregone conclusion], Dagens Industri, 21 August and T. Laitila (2023) "Riksbanken måste sluta skrämmas – inflationen är bara ett spöke" [The Riksbank must stop scaring us – inflation is just a ghost], Göteborgs-posten, 21 August. Both these articles are in Swedish only.

[2] See, for example, the article "How quickly will inflation fall?" in *Monetary Policy Report*, April 2023 and Chapter 3 in *Monetary Policy Report*, June 2023.

[3] See, for example, Figure 3 in Chapter 1 and Figures 29 and 32 in Chapter 3 of the draft report.

percentage changes, but is particularly striking for price changes from month to month.

That inflationary pressures right now continue to be too high, however, does not change the fact that the conditions exist to gradually reduce them. Contributory factors to this, in both Sweden and other countries, are that the pandemic-related imbalances between supply and demand have successively decreased and, above all, that monetary policy has been tightened decisively and rapidly.

Furthermore, in Sweden there are a few more circumstances that are particularly beneficial when it comes to the conditions for being able to avoid inflation becoming entrenched at too high a level for longer. In the same way as they have done for quite some time, longer-term inflation expectations continue to convey the picture of strong confidence in the inflation target. This confidence is also evident in wage formation, where it is clear that Swedish wage-setters are aiming for wage increases that are compatible with inflation returning to 2 per cent. In addition, the Government has communicated that fiscal policy will not hamper the possibilities to bring down inflation, something for which the forecast for general government net lending in the draft report, with relatively minor deficits in 2024 and 2025, also provides support.

The development of inflation going forward is naturally not without risks, which I will return to shortly in my monetary policy discussion. But in this situation there is rather little to justify making a larger, more fundamental revision to how quickly inflation is expected to return to target. This is also the perspective in the new proposed forecast in the draft report, where relatively minor revisions are suggested.

The most important revision being proposed stems from the outcome for inflation stripped of energy prices that was a couple of tenths of a percentage point higher than expected in August. As this is not considered to be due to temporary effects, it has led to the forecast for price developments excluding energy prices being revised up in approximately this magnitude over the coming year. Apart from certain technical adjustments in the assumption for energy prices during the second half of 2024, the forecast revisions for inflation including energy prices are generally small. The krona exchange rate is slightly weaker than in the assessment from June, which contributes to somewhat higher inflation in the forecast, but this is counteracted by some deterioration in real economic developments. The inflation forecasts slightly further ahead, both with and without energy prices, are therefore largely unchanged. And thus target achievement has not been materially changed either, compared with the assessment in June. Inflation is still expected to be close to target in 2024.

To achieve a development of inflation in accordance with these forecasts, it is assumed in the draft report that the Riksbank will continue to tighten monetary policy. More precisely, it is presumed that the policy rate will be raised by 0.25 percentage points to 4 per cent at today's meeting. A higher policy-rate path is also contributing to the tightening of monetary policy, where the assumption now is that the policy rate will peak at 4.10 per cent, compared with 4.05 per cent in June. Just as in the assessment in June, the policy rate is expected to start to fall slightly during the second half of 2025. At the end of the forecast period, which is the third quarter of 2026, the policy rate is expected to be at 3.69 per cent as a quarterly average.

I support the forecasts in the draft report. I also support the monetary policy assumptions made in the draft. That we are now tightening monetary policy slightly more than we planned to do in June I find to be entirely reasonable – the updated inflation forecast is slightly higher than before even conditioned on this somewhat tighter monetary policy.

Even though I think that our new monetary policy plan currently is well-balanced, I continue, just as in June, to see certain risks that we may need to revise the plan further in a tighter direction going forward. Although the risks linked to the possible effects of the weak krona exchange rate on service prices and wages – which I discussed at the June meeting – have fortunately so far not materialised, inflationary pressures in the Swedish economy are still far too high. Excluding energy prices, inflation measured as an annual percentage change is more than 5 percentage points above the inflation target. Measured over shorter periods than one year, it looks a little better, but even in this case it is still a number of percentage points above the target, as illustrated in Figure 29 in the draft report. With such a point of departure, it feels risky to assume that it will suffice to just increase the policy rate by a few more basis points, to be able to successfully bring inflation back to target. This may work, but I find it difficult to conclude anything other than that the risks to the interest rate in these circumstances are on the upside.

Neither is the continued constant depreciation of the krona exchange rate naturally something that makes it easier to manage the high inflation rate. An article in the draft report discusses various feasible reasons why the development in the krona looks like it does.[4]

One conclusion drawn in this article is that it has been difficult to fully understand the development of the krona exchange rate based on interest-rate differentials in relation to other countries, especially most recently when the krona has depreciated more against the euro than against the US dollar. But the krona's

[4] See the article "The krona will strengthen in the medium term" in the draft report.

development against the dollar, particularly last year, nevertheless suggests that interest-rate differentials are one of several factors that play a part. Against this background, it seems unwise to underestimate the significance for the krona of further rate increases by the Riksbank in a situation where many market participants believe that both the ECB and the Federal Reserve have reached their policy-rate peaks this time around. As discussed in the article, there may be several factors in such a situation that turn to the krona's advantage and thus lead to it appreciating relatively rapidly. This would really be welcome.

First Deputy Governor Anna Breman:

I support the proposal to raise the policy rate, the rate path and the forecasts in the draft Monetary Policy Report.

The Riksbank's monetary policy is dampening demand and contributing to the current downturn in inflation. Since the last monetary policy meeting, our target variable CPIF has fallen to 4.7 per cent as an annual rate in the latest outcome for the month of August. The CPIF excluding energy has also decreased, to 7.2 per cent as an annual rate according to the latest outcome, but the decline is significantly slower. Forward-looking indicators suggest that inflation will continue to fall towards the target. However, it is important to emphasise that this will not happen by itself. A sustained decline in inflation is contingent on monetary policy remaining contractionary.

At today's meeting, the difficult question is whether it is enough to leave the policy rate at current levels or whether further tightening is needed to reach sustainably low and stable inflation. My view is that a rate hike would be a well-balanced measure at today's meeting. To justify this position, I would like to start by commenting on the causes of the upturn and downturn in inflation before going into the monetary policy considerations.

The pandemic and Russia's illegal invasion of Ukraine triggered the sharp increase in inflation. This is often considered purely in terms of supply shocks but it was the imbalance between supply and demand that led to such a high upturn in inflation. Companies could pass cost increases on to households because demand was strong as pandemic restrictions were lifted, employment increased and households had excess savings from the pandemic. In addition, households rapidly changed their consumption patterns in favour of services such as travel, restaurant visits, entertainment and recreational activities at the expense of other consumption (see Figure 2 in the MPR June 2023). This contributed to a rapid rise in service prices despite service companies' costs being dominated by wages that were only increasing at a moderate pace.

The Riksbank's monetary policy is now dampening demand, supply chains are working better, the price of electricity has fallen and food prices have started to stabilise. These factors are contributing to the fall in inflation. What remains is for inflation to come all the way down to the target and then stay at a low and stable level. High inflation is problematic for the economy as a whole and particularly painful for households with small margins. It is a return to sustainably low and stable inflation that enables rising real wages, competitive companies and increased prosperity for Sweden as a country.

In light of this, let me discuss the monetary policy considerations at today's meeting. There are three main reasons why I support a rate hike and a policy rate path that indicates further rises are possible this year and next year.

First, demand remains relatively high in parts of the Swedish economy that are important for the development of inflation going forward, in particular in the service sector. One important question is whether households will continue to prioritise the consumption of services over other consumption. Another concerns how much households are able and willing to use their savings buffers to maintain this consumption.

We know that households' liquid savings were already high before the pandemic and it is likely that households still have some of their excess savings accrued during the pandemic (see the article Household savings increased significantly during the pandemic in the draft report). However, the Riksbank's analysis of household savings shows that there is no clear-cut answer to how these will affect consumption in the period ahead. Savings are unevenly distributed among households. This is why I emphasise that, for some households, it is a matter of wanting to use the savings buffers, while margins are small for others. As we do not have statistics on liabilities and assets at the household level, we do not know what the distribution looks like among different households. This question is particularly important at present as it matters whether households can and want to use these savings buffers to smooth their consumption over time. Household expectations also matter (for a longer discussion, see my contribution at the monetary policy meeting in June). If households expect rate cuts in the near future, their tendency to use their savings for ongoing consumption will increase, maintaining demand and thereby inflation.

Second, a broad downturn is needed in all price categories for inflation to be sustainably low and stable. The downturn in electricity prices is excellent and is contributing to the fall in inflation but it is not enough as the effect of falling electricity prices will fade away, after which inflation will be determined by price categories that are less volatile, such as service prices. Service prices remain at levels that are not compatible with low inflation regardless of whether we measure it as an annual rate or as annualised monthly rates (see Figures 3, 31 and 32 in the draft report for different methods).

Another important issue related to energy prices is that corporate pricing behaviour tends to be asymmetrical. This means that companies tend to pass increased costs on to households by raising prices but that they do not tend to cut prices for households when costs fall. Let me explain how this can affect inflation in the period ahead via energy prices. Energy prices consist of both electricity prices, which are falling sharply, and fuel prices, which have risen recently due to higher oil prices. Both electricity prices and fuel prices have a direct effect on inflation but they also have an indirect effect as companies' costs rise or fall when electricity and fuel are used in the production of other goods and services. If companies' pricing behaviour is asymmetrical, rising oil prices could thus be more important than falling electricity prices for inflation in the period ahead via the indirect effects on other goods and services. Tight monetary policy can counteract this asymmetry by restraining demand and making it more difficult for companies to raise prices for households.

Third, the depreciation of the krona is counteracting the downturn in inflation (see the article "The krona will strengthen in the medium term" in the draft report). A trend depreciation of the krona is more problematic than temporary fluctuations in the exchange rate. Among other things, a weak krona affects prices for goods and food. It is notable that the downturn in prices for goods is sluggish even though the pandemic-related supply disruptions that pushed these prices up have faded away (see Figure 30 in the draft report). In a small, open economy, the transmission of monetary policy works via both market rates and the exchange rate. Transmission via market rates has worked largely as normal, with the exception of sluggishness among many banks when it comes to raising deposit rates. However, transmission via exchange rates has worked poorly as the krona has depreciated despite a monetary policy stance that is comparable to that of neighbouring countries. Raising the policy rate in combination with the expanded sale of government bonds decided at the last meeting can counteract a further weakening of the krona. A stronger krona can contribute to falling inflation.

In addition to a policy rate rise, I support the upward revision of the policy rate path. Our monetary policy strategy must allow for the possibility of setbacks on the way back to sustainably low and stable inflation, in which case a further rise this year and/or next year may be necessary. The risk outlook is still on the upside, meaning that the risk that inflation will be higher than forecast is greater than the risk it will be lower. The risk outlook includes continued high core inflation, a weak krona, a slowdown in China, the difficult geopolitical situation and climate change that may push up energy and food prices. When we are coming from a situation with high inflation, it is more problematic if inflation is higher than forecast than the reverse (see alternative scenarios in Chapter 1 of the draft report).

Finally, I would like to comment on the labour market. Despite restrained demand and weaker development of the real economy, the labour market is showing resilience. This is good. Due to the responsibility shown by the social partners, the conditions are favourable for bringing down inflation while maintaining a high employment rate (see Figures 9 and 36 in the draft report). However, there are now signs that the labour market is starting to cool. The labour market will be important for coming meetings, as a weaker labour market could lead to a larger downturn in demand and ultimately inflation, reducing the likelihood of further tightening. However, as always, it will be an overall assessment conditioned on many indicators of the direction of inflation that will determine a well-balanced monetary policy at coming meetings.

Allow me to summarise. Monetary policy is restraining demand and helping to reduce inflation. The conditions are favourable for a continued decline in inflation but this rests on monetary policy staying the chosen course. It is now primarily service prices, combined with a weak krona, that are holding up inflation in Sweden. I therefore support a rate hike at today's meeting, along with an upward revision of the policy rate path. Monetary policy needs to be contractionary for a period to come in order for us to return to sustainably low and stable inflation.

Governor Erik Thedéen:

I support the proposal to raise the policy rate by 0.25 percentage points to 4 per cent. I also support the forecasts presented in the draft Monetary Policy Report. These entail, for instance, that the policy rate may be raised further after today's increase, and that monetary policy will need to be contractionary for the foreseeable future. This is necessary for us to be reasonably sure that inflation will continue to fall sufficiently quickly and then stabilise around the target of 2 per cent in 2024. Monetary policy also includes selling government securities from our portfolio. We will continue at the pace previously decided, that is, SEK 5 billion per month. As I said earlier, I consider that these sales should be gradual and predictable.

Since the previous monetary policy meeting at the end of June, economic developments in many areas have been weaker. One exception is the US economy, which is continuing to show reasonable growth, despite a much higher interest rate environment. Moreover, the US labour market is still strong, at the same time as inflation is falling. Economic developments in our vicinity appear weaker, however. For the euro area as a whole, our forecast for coming quarters has been revised down. Industrial production is increasingly weak, particularly in

Germany. In the new OECD forecast from 19 September, Germany has negative GDP growth during 2023.

Of course, the weak developments in the euro area are not beneficial for the Swedish economy. Indicators point to growth being weak in the coming quarters. Confidence indicators have deteriorated and the decline is now broader than at our earlier meetings in 2023. Swedish GDP is expected to continue shrinking in the final two quarters of the year. At the same time, it is important to point out that, compared with other European countries, Swedish GDP is falling from a high level, which is a reflection of the downturn during the pandemic being smaller and the recovery following the pandemic being stronger than in the euro area. What we see ahead of us is a mild recession, with positive growth figures next year. The signs of strength in the Swedish economy include the labour market, which has so far shown a very strong resilience, and the employment rate is record high, even if the outcome for August was clearly weaker. However, indicators point to the demand for labour slowing down now, and in our forecast unemployment rises going forward.

There are now clear signs that the rate of price increase is slowing down. We can see this in the prices for input goods and food. It is also expressed in the National Institute of Economic Research’s measurement of company's pricing plans. We have also received several new inflation outcomes since the previous monetary policy meeting that point in the right direction, although parts of the incoming inflation outcomes have been somewhat higher than our forecast from June. From a peak of more than 10 per cent at the beginning of the year, CPIF inflation has now fallen to 4.7 per cent. Underlying inflation measured as the CPIF excluding energy is also continuing to fall. This is a development roughly in line with our forecasts, and something that is not only due to last year’s rapid upturn in for example energy and food prices that are now falling out of the 12-month figures. The downturn in inflation is to a great extent due to the interest rate rises having the desired effect of softening economic activity and also sustaining confidence among companies and households that the inflation target will be achieved long-term in a reasonable time horizon. It is very important that we attain our inflation target to ensure good economic development, which includes not least a return to rising real wages.

However, with an inflation rate of 4.7 per cent according to our target variable CPIF, inflation is still too high. The development of various sub-components of the CPIF also indicate that the inflation trend is not yet in line with our inflation target. Inflation measured by CPIF excluding energy, which comprises more than 90 per cent of the CPIF, is now at 7.2 per cent. Looking only at services prices, which make up just under half of the CPIF, increased by 7.0 per cent in August. The short-term trend is also still too high, which is of particularly great significance now that there are signs of a turnaround in inflation. If, for example, one looks at developments over the past three months calculated at an annual rate, the rate of increase for service prices is 4.9 per cent. When the CPIF excluding energy is calculated in the same way, it is also far too high, that is to say 4.8 per cent. However, the short-term development in energy prices is clearly negative, -18.2 per cent, although this is not likely to continue for any length of time.

The relatively complex and uncertain picture of current and future inflation – where different parts of the CPI basket are pointing in partly different directions – indicates that the Riksbank should have an open and vigilant attitude and that there is a considerable need to monitor developments on a regular basis.

Inflation and a higher interest rate environment have implied major adjustment for large parts of the Swedish economy. Household consumption has been weak, especially the consumption of goods. Housing investment has fallen sharply since 2022, and is expected to continue falling.

The commercial real estate sector has to struggle with sharply rising interest costs, but the picture is heterogeneous; some companies are heavily exposed, while many other real estate companies have a much better initial position. A process of adjustment has begun in the real estate sector, where many companies are striving to strengthen their balance sheets through, for instance, real estate sales and capital acquisition to reduce the loan burden. This is a much-needed process which should be speeded up. In an overall assessment I see the risks in the real estate sector as manageable, provided that inflation comes down to the inflation target in line with our forecast, and that economic developments in general stabilise.

Compared with the previous monetary policy meeting, the value of the krona is slightly weaker in trade-weighted terms, after first strengthening and then weakening. The krona is thus still undervalued according to most analyses. The krona’s development is important to the Riksbank as it affects inflation. As we showed in the June Monetary Policy Report, there are several indications that the pass-through from a weak exchange rate to rising inflation may be greater than we had previously assumed. This constitutes an upside risk to our assessment of inflation.

To be able to achieve our inflation target within a reasonable period of time, it is therefore important that the krona does not weaken further. It will be easier to achieve the inflation target if the krona strengthens, for which all the conditions should be right, given the macroeconomic developments in Sweden in relation to the rest of the world, and the fact that the krona is undervalued from the start. We further develop this reasoning in an article in the Monetary Policy Report. The article also contains an analysis that I consider interesting and that indicates that relatively short-term and financially motivated foreign exchange transactions of various types have increased in scope. However, such flows can rapidly turnaround in line with changed conditions and assessments on the markets. This indicates that when the krona begins to strengthen, it could happen fast. Participants active in the krona market should bear this in mind.

Before I describe my opinion of how monetary policy should be designed, I would like to briefly touch on how I view the risks that the development could deviate from the main scenario on which the Executive Board's assessments are based. One risk is that domestic demand will slow down even more than is forecasted, and that this will cause inflation to fall even faster than we have assumed. Against this is the risk that the downward inflation trend will suffer setbacks. It is of some concern that oil prices have risen recently, and renewed supply shocks for various goods as a result of, for instance, Russia's ongoing invasion of Ukraine cannot be ruled out. I have already mentioned that a prolonged krona depreciation is a risk factor in itself, with regard to the development of inflation. If these risks materialise, we need to be prepared to act. In my opinion, the upside risks for inflation in relation to our forecast still dominate.

Allow me to conclude with my monetary policy deliberations. Central bank monetary policy rates have been raised at a rapid rate in Sweden and many other parts of the world during 2022 and this year. The most recent communication from the ECB has been interpreted by the market to mean that they have attained roughly the right level for their policy rates, and that the aim now is to remain at the current levels for a longer period of time. In my opinion, the Riksbank is not there yet. That is, after today's increase of the policy rate to 4 per cent, I can envisage further tightening being necessary so that we can be reasonably sure that inflation will continue down to our target of 2 per cent. This need not be at the next meeting; further tightening can come at a later stage. The interest rate thus needs to be contractionary for the foreseeable future, which is also shown in our rate path.

A decisive factor for my stance at coming meetings is what new information has to say about the outlook for inflation and economic activity and the risk outlook. What I personally intend to monitor carefully is how the trend develops in the different existing measures of underlying inflation, and then act to ensure that inflation continues clearly downwards and stabilises at around 2 per cent.

§4. Monetary policy decisions

The Executive Board decided

- on monetary policy measures in accordance with the provisions of the draft Annex A to the minutes, Policy rate decision. The policy rate will be raised by 0.25 percentage points to 4 per cent and this decision will apply from Wednesday 27 September 2023.
- to establish the Monetary Policy Report according to the proposal, Annex B to the minutes Monetary Policy Report,
- to publish the monetary policy decision with the reasons for it in a press release at 09.30 on Thursday 21 September 2023,
- to publish the minutes from today's meeting at 09.30 on Monday 2 October 2023.

This paragraph was confirmed immediately.

Minutes taken by

Bul Ekici Magnus Jonsson

Verified by

Erik Thedéen Anna Breman Aino Bunge

Martin Flodén Per Jansson

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