Monetary policy minutes

February 2024

MONETARY POLICY MINUTES

Executive Board, No. 1

DATE:	31 January 2024
TIME:	09:00
INFORMATION CLASS:	RB PUBLIC
PRESENT:	Erik Thedéen, Chair Anna Breman Per Jansson Martin Flodén Aino Bunge --- Bo Broman, Chair, General Council of the Riksbank Tomas Eneroth, Vice Chair, General Council of the Riksbank --- Björn Andersson Lena Arfalk Hanna Armelius Carl Andreas Claussen Vesna Corbo Charlotta Edler Mattias Erlandsson Susanna Grufman Peter Gustafsson Anders Gånge Christina Håkanson Anders Kvist Björn Lagerwall Pernilla Meyersson Ann-Leena Mikiver Emma Sandberg Åsa Olli Segendorf Ulrika Söderberg Liza Tchibalina --- Buster Carlsen (§1–3a) Maria Johansson (§1–3a) Olof Sandstedt (§1–3b) Anne Mattila Wass (§3b)

It was noted that Björn Andersson and Liza Tchibalina would prepare the draft monetary policy minutes.

Postal address: SE-103 37 Stockholm, Visiting address: Brunkebergstorg 11
Telephone: +46-(0)8-787 00 00, **Website**: riksbank.se

§3 a. Economic developments

Market developments since the last monetary policy meeting

Buster Carlsen, economist at the Markets Department, presented the latest developments on the financial markets. Interest rate movements since the previous monetary policy meeting in November 2023 have been divided, with a turnaround since the start of the new year. Signals from the larger central banks that interest rates had probably peaked led to clear falls in interest rates at the end of 2023. The falls were also motivated by an increased belief in interest rate cuts in 2024. Central banks began the new year by communicating scepticism towards expectations of early policy rate cuts, which together with data showing a particularly resilient US economy, led to interest rates rising. To summarise, and in comparison with November, market expectations of policy rate cuts have increased, and now an initial rate cut is expected during the first half of the year from both the ECB and the Federal Reserve.

Higher interest rates caused the positive sentiment on stock exchanges to cool off at the beginning of 2024. However, the market's stronger belief in rate cuts has contributed to stock exchanges in the United States and Europe continuing to rise, and the broad US stock market indices note record levels. At the same time, the Chinese economy has shown a subdued development, which has led the Chinese government to plan support measures to limit the stock market falls. In China and Hong Kong, uncertainties still remain as to whether the recent stock market increases will be maintained as a result of the measures implemented, and whether the stimulus will benefit economic growth in a lasting way.

Maritime traffic in the Red Sea and the Suez Canal remains very limited after continued tensions in the region. In recent months, tensions have escalated further after US and British military attacked targets linked to Houthi rebel groups supported by Iran. These have in turn continued to attack cargo ships. Despite previously minor reactions in the oil price, it has now increased as a result of concerns that the conflict in the region may escalate further.

Market analysts are expecting the Riksbank to leave the policy rate unchanged when the decision is published on 1 February. At the same time, there is agreement that the Riksbank will announce an increase in the pace of sales of government bonds, and analysts are assuming that the sales will increase to a new pace of between SEK 6.5 and 8 billion. The positive risk sentiment at the end of 2023 contributed to the clear strengthening of the krona. Since the start of the year, however, the krona has weakened, which the market believes to be due to a combination of the earlier rapid strengthening and a broad strengthening of the US dollar.

Deputy Governor Martin Flodén asked a question to clarify what the pricing of RIBA contracts implies for expectations of the Riksbank's monetary policy in the near term.

Buster Carlsen replied that the RIBA pricing does not indicate any expectations of a cut at today’s meeting, but a small probability of a cut at the March monetary policy meeting. However, one should interpret the implied expectations in the RIBA contracts with caution.

Financial stability – current situation and risks

Olof Sandstedt, Head of the Financial Stability Department, described the situation in the Swedish financial system. The system is working well overall but the risks are elevated. The major Swedish banks are assessed to be in a good starting position and have a high level of profitability. At the same time, the increase in corporate bankruptcies has had a limited impact on the banks’ loan losses, which are low. The banks still have a margin down to the formal capital requirements, which is important in these uncertain economic times.

The higher interest rates are still posing a challenge to the ability of several property companies to service their debt and contributing to a decline in the value of properties. Some property companies have been able to issue bonds to a somewhat greater extent, but many have funded maturities through increased bank loans, combined with, for instance, sales of properties. The risks linked to the large loans in the property sector are still elevated and property companies need to take further measures to reduce their financial risk. In addition, the higher costs are putting pressure on households’ margins and the risk of debt servicing problems among those with consumption loans in particular has increased.

The current monetary policy drafting process

Carl Andreas Claussen, Senior 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 18, 22, 23 and 25 January. This is the first monetary policy meeting according to the new system, where the Executive Board holds eight ordinary monetary policy meetings a year. A Monetary Policy Report with forecasts including an interest rate path will be published after every second meeting. At the remaining four meetings, a shorter Monetary Policy Update containing the Executive Board’s deliberations is published, but no new forecasts. This is the first meeting with a Monetary Policy Update.

As shown in the draft Monetary Policy Update, the Executive Board has reviewed new information and discussed how this affects the prospects for economic activity, inflation and monetary policy. A central question has been whether the risk outlook for inflation has changed and if so, how this affects the prospects for monetary policy.

With regard to new information and prospects going forward, it can be noted that the economic slowdown abroad has continued roughly in line with the forecast in the November Monetary Policy Report. Inflation prospects abroad have improved. However, war in Europe and increased geopolitical tensions in the Middle East create considerable uncertainty over energy prices, food prices and freight prices going forward.

Expectations of future policy rates abroad have shifted clearly downwards. After previously holding the door open for continued rate increases, many central banks are now saying that the interest rate has probably peaked. Announcements by both the Federal Reserve and the ECB indicate that rate cuts could begin in the summer.

The Swedish krona is now at around the same level as at the monetary policy meeting in November, but has fluctuated considerably. Swedish market rates have fallen significantly since the autumn and this is reflected in the lending rates on longer interest-rate fixation periods charged to households and companies. Growth in corporate credits has weakened further, and household borrowing is still at a historically low growth rate.

The economic slowdown in the Swedish economy is roughly in line with the most recent forecast. The slowdown is largely driven by the interest-sensitive parts of the economy, such as household consumption and housing investment. At the same time, the development of investment in other areas of the business sector has been surprisingly strong. The risk outlook regarding economic prospects is similar to that in November. There remains some uncertainty regarding Swedish household consumption and saving, and developments on the labour market are uncertain, with many companies so far choosing to retain staff despite the economic slowdown. A more prolonged economic slowdown could lead to greater adjustments among both households and companies.

Inflation in Sweden has continued to fall, and when measured in terms of the CPIF excluding energy has been lower than expected. Forward-looking indicators point to a continued fall in inflation and price changes in the shorter term are close to 2 per cent when calculated as an annual rate.

The risk outlook for inflation is affected by geopolitical tension, the krona exchange rate and uncertainty over companies' pricing behaviour. But at the same time, the risk of inflation becoming entrenched at levels that are too high appears to have declined. Following a longer period during which inflation was much higher than expected, price increases have recently declined in line with the Riksbank's forecasts. Activity in the Swedish economy has slowed down, and inflation has fallen substantially, both in Sweden and abroad. In addition, inflation expectations are close to the target and wages are increasing moderately.

The monetary policy proposal described in the draft update 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 is that the policy rate is held unchanged at 4 per cent at today's meeting and that the Executive Board signals that it now envisions the policy rate being cut earlier than was forecast in November. The proposal also entails the sales of nominal government bonds being extended to SEK 5.7 billion per month, while the rate of sales of real government bonds is retained at SEK 0.8 billion per month.

§3b. The economic situation and monetary policy

Deputy Governor Martin Flodén:

I support the proposal to hold the policy rate unchanged today and to increase the rate of sale of government bonds. I also support the analyses and considerations presented in the draft Monetary Policy Update.

Developments since our monetary policy meeting in November have mainly been favourable from a monetary policy perspective.

In 2022 and 2023, inflation became considerably higher than the inflation target. Moreover, during almost all of this period, inflation turned out higher than the forecasts we had just published. This tendency now seems to have been broken. Inflation fell rapidly in the second half of 2023. In addition, the latest outcomes for underlying inflation were slightly below our forecast. The development of inflation looks quite positive even when the details behind recent months' price movements are examined.

One concern is that companies' price plans in the Economic Tendency Survey remain a little high, but several other signs indicate that recent months' fairly modest price rises will persist. For example, several major retailers have announced plans to cut prices for many goods, which was also indicated in our business survey in the autumn. I also note that wages are continuing to increase at a modest pace in relation to the high inflation of recent years.

Another glimmer of light is that the krona has not depreciated since our last meeting. Short term expectations of the policy rates of the ECB and Federal Reserve have fallen clearly in recent months due to the improvement of the prospects for lower inflation internationally. Lower inflationary pressures and interest rate expectations abroad are facilitating, via the exchange rate, the Riksbank's possibilities for combating Swedish inflation without it being necessary to raise the policy rate further.

The real economy has developed approximately as we assessed at the last monetary policy meeting. In other words, we see clearly subdued activity in some parts of the economy and that unemployment has risen somewhat but that, despite this, employment is on high levels.

All of this strengthens the view that inflationary pressures are returning to levels that are compatible with the inflation target.

In the last Monetary Policy Report, we presented two alternative scenarios. In one scenario, inflation continued to be surprisingly high as a result of companies trying to have unusually high margins against their costs. The Riksbank would then have to raise the policy rate more to continue to dampen demand in the economy.

In the second scenario, inflationary pressures instead became lower due to an unexpectedly rapid slowdown in the real economy. The Riksbank would then be able to cut the policy rate considerably sooner than indicated by the policy rate path.

In light of the brighter inflation picture we now see, the risk of an unfavourable scenario in which we need to continue to raise the policy rate has decreased considerably.

While it is true that the real economy has not become surprisingly weak, underlying inflation has still become three-tenths lower than our forecast from November. My current assessment is that the policy rate path in the optimistic alternative scenario, with a policy rate cut in the second or third quarter of this year, seems increasingly reasonable as a likely scenario for a well-balanced monetary policy going forward.

My thinking is that such a scenario is based on three conditions:

First, that the underlying monthly rate of inflation continues to be in line with the inflation target and presumably that the annual rates continue to be clearly in line with the forecast from November.

Second, that the krona does not again start to depreciate, and, additionally, that early rate cuts are not deemed to lead to such a depreciation.

Third, that other indicators of the inflationary pressures continue to develop positively. Here, I am mostly thinking of the international risk outlook, as well as inflation expectations and companies' price-setting behaviour.

Pricing on the financial markets indicates the view that there is a not insignificant probability that we will cut the policy rate as soon as the next monetary policy meeting in March. If I am to see such an early rate cut as justifiable, the conditions for both inflation and the real economy will probably have to change considerably in the coming months. If anything, this would likely be a risk scenario in which economic activity slows down faster than expected, both in Sweden and abroad.

It is easier to see risks for setbacks that would result in the policy rate having to remain contractionary for a longer time. As the draft update points out, the most tangible risks now concern geopolitical developments with possible effects on commodity and freight prices, on global value chains and on the krona exchange rate.

Finally, I would like to comment on my support for the proposal to sell government bonds at a faster pace. Earlier sales have worked well. Actors on the financial markets say that the functioning of the market has improved. In addition, the sales are reducing the financial risks on the Riksbank's balance sheet. I do not expect any tangible monetary policy effects of the faster sales but, if such effects arise, they can be countered by future policy rate adjustments, if necessary.

Deputy Governor Per Jansson:

I support the decisions to leave the policy rate unchanged at 4 per cent and to increase the sales of government bonds from SEK 5 billion to SEK 6.5 billion per month as from February this year. I also support the economic assessments presented in the draft Monetary Policy Update. In keeping with the change to the structure of my contribution, which I made at our previous meeting on 22 November last year, I will focus my comments today on my monetary policy considerations and in particular on aspects of these that add nuance to, or perhaps even slightly deviate from, the description in the draft update.

At our last meeting, I clarified that my view of monetary policy during the autumn last year had clearly shifted in a more optimistic direction. At the time, I discussed three factors that were of particularly major significance for this turnaround: that new inflation outcomes, underpinned by various indicators, showed sharply and broadly declining inflationary pressures; that the Swedish economy was clearly starting to cool and therefore did not constitute an inflationary environment; and that the krona exchange rate had appreciated quite considerably, reducing the risk of problematic exchange-rate-driven inflationary impulses. Let me give a brief update on how I see these factors in the current situation.

Of course, the most important factor continues to be the development of inflation itself. Since our last meeting, we have had two new inflation outcomes, for November and December, which indicate that inflationary pressures are continuing to ease. Inflation excluding energy prices remains well above the inflation target, at 5.3 per cent, which emphasises the need for monetary policy to remain contractionary for a while longer. But the decline is slightly faster than we anticipated, which is obviously good news.

It is of considerable significance that the rate of price increases over shorter periods than the usual twelve months continues in general to slow. I do not find the rebound of certain monthly changes in December compared to November to be particularly worrying – on a monthly basis, the volatility in price increases is quite simply large. If we instead look at the rates of price increases over the last six or three months, the downward trends are by and large still intact, with some tendencies to level off for some measures of underlying inflation and larger consumer price sub-groups. But the tendency of these trends to level off as they approach the inflation target is only a good thing as it reduces the risk of inflation falling too low going forward.

As in November, there are also indicators other than the inflation outcomes themselves that support the conclusion of a brighter inflation picture. These are commented on in the draft update, which, as I have said, I support.

Also regarding the situation in the Swedish economy, I consider the conclusions I drew at our November meeting last year to still be valid. It is clear that economic developments continue to cool. This is not least true of the labour market, where employment is falling, unemployment is rising and various indicators, such as recruitment plans, redundancy notices and bankruptcies, generally suggest a weak development. As I stated in November, this is in itself obviously nothing to be pleased about. But as it, at the same time, reduces the risk of inflation becoming entrenched at a high level and therefore enables faster policy-rate cuts than otherwise, there is nevertheless something positive for the real economy in this, albeit in a slightly longer time perspective. As I have said many times before, the worst thing that can happen for the real economy is inflation remaining high for so long that confidence in the inflation target starts to falter. The policy rate would then have to be raised significantly more than we have done thus far, and, in spite of this, it would probably take even longer to bring inflation down to the target again.

Turning to the krona exchange rate, developments are unfortunately not as encouraging. Although the krona is approximately unchanged against the euro and the US dollar compared with at the time of our last meeting on 22 November, developments since then, firstly with a sharp appreciation after the meeting up to about the turn of the year and then with more or less just as sharp a depreciation, are worrying. It is clear that the krona's value is affected to a considerable extent by the risk appetite in global financial markets. Against this backdrop, continued or increased geopolitical tensions that dampen this risk appetite could lead to the krona exchange rate continuing to depreciate in the period ahead. And in bad scenarios, the depreciation could be considerable. But relaxations in monetary policy abroad, primarily from the ECB and the Federal Reserve, could affect the krona exchange rate in the opposite direction.

My conclusion as regards the krona is that it will be very important going forward to follow developments carefully and that the timing of rate cuts at the major central banks abroad is a factor that may have significant bearing on when it is appropriate to also start relaxing monetary policy in Sweden. It is worth emphasising that it will always be a question of how the overall prospects for inflation are assessed to be affected, because, as we know, we have no target for the krona exchange rate.

Summing up my review of these three factors, I draw approximately the same overall conclusion as the draft update. The conditions for starting to cut the policy rate earlier than in the forecast from November have improved. Of greatest significance here is that concrete data show that we are making progress in the fight against inflation and that things are even going slightly better than expected. At the November meeting, there was a concern that the improvements in the inflation picture were highly dependent on a single inflation outcome, the one for October. But now there have been two more outcomes, providing more solid ground for our analyses to rest upon and thus allowing us to give them greater consideration in our monetary policy deliberations.

That said, I also share the concern over setbacks described in the draft update. A continued depreciation of the krona is, as I said, a factor to take into account in the context. An unfavourable development of the krona can, as I mentioned, come from geopolitical tensions. But such tensions can also create new supply disruptions, like those we experienced during the pandemic. This may in turn lead to cost shocks, which companies might continue to pass on unusually rapidly to consumer prices. If such pricing behaviour persists among companies, a weaker krona exchange rate could also lead to an even bigger problem from an inflation perspective.

In light of this, I fully and totally share the view in the draft update that monetary policy going forward must be characterised by caution, where each step is carefully examined and considered. Implementing a first policy-rate cut as early as in March is something that I currently do not consider impossible but nor do I think it is particularly probable. For this to come into question, not only must the favourable development of inflation continue, but the plans for policy-rate cuts from the major central banks abroad will probably also need to be outlined much more clearly. Here, a first rate cut at the meeting either in May or in June currently feels significantly more realistic. But unfortunately, neither is it possible to rule out the first cut not coming until after the summer, in a worse scenario.

In any event, the uncertain and volatile situation in the global economy means that I would be surprised if policy rates in the period ahead, in both Sweden and other countries, are cut repeatedly at successive meetings. I find it difficult to imagine such a direct journey without slowdowns and hold-ups. It is my guess that there will be a need to pause to await more information and allow uncertainty to dissipate. Pursuing a well-balanced policy in this way reduces the risk of having to turn full circle and increase the rate again. And we obviously want to avoid that. Calibrating a quantitative rate path that captures all these aspects will naturally be a formidable challenge – but we have a few more months before we need to do that.

Deputy Governor Aino Bunge:

I support both the proposal to leave the policy rate unchanged at 4 per cent at this meeting, and the assessments made in the draft Monetary Policy Update. This also means that I support the proposal to increase the pace of the sales of government bonds from SEK 5 billion to 6.5 billion per month.

Inflationary pressures in Sweden and abroad are now on the way down after a period of very high inflation. In Sweden, inflation fell to 2.3 per cent in December, measured in terms of the CPIF. Measured in terms of the CPIF excluding energy, it was 5.3 per cent, which was lower than expected. Following a period during which inflation outcomes were higher than expected, inflation has recently fallen approximately in line with our earlier forecasts. This is illustrated in a good way in Figure 7 of the draft update. The fact that inflation is falling in line with our assessments creates greater security that the inflation trend has turned. Price changes in the short term are now in general close to 2 per cent when calculated as an annual rate (see Figure 5 in the draft update), which provides further support for this conclusion.

The real economy is slowing down, largely in line with our November forecast, providing conditions for a decline in inflationary pressures. Moreover, long-term inflation expectations have remained stable while short-term expectations are falling. Given how high inflation has been, wage growth in the Swedish economy must also be regarded as moderate. All of this supports the assessment that the risks of inflation becoming entrenched have declined.

To illustrate the uncertainty in the development of inflation and monetary policy in the medium term, we now use scenarios in our Monetary Policy Reports. Developments since November have been more in line with the favourable scenario for inflation presented then. But it is important not to forget that there are still clear risks of setbacks.

The episode with high inflation that we have experienced in recent years originated from events outside our borders, such as the pandemic and a war in Europe. Unfortunately, the geopolitical tensions still remain and risk worsening. There is thus a heightened risk of global supply shocks, which could lead to unexpectedly high inflation going forward.

Another scenario that could lead to higher inflation is that the krona exchange rate does not strengthen as expected. The krona is largely at the same level as in November, but has varied a lot. A weaker krona rate can, for instance, risk turning around the positive trend we are now seeing in goods prices. The exchange rate and its pass-through are something we need to focus on, and that will influence monetary policy.

During the period with high inflation, companies have passed on increased costs, including those arising from the exchange rate, to consumer prices at a faster pace and to a greater extent than normal. The National Institute of Economic Research has been commissioned by the Government to analyse how prices in Sweden have increased in relation to business sector costs.[1] The main conclusion is that overall consumer prices (the CPIF) have risen around the same amount as costs, but at the same time this is more than is indicated by historical patterns. Prices have increased more than costs on some goods. Although data on price plans indicate that the propensity to raise prices is not as great as before, the price plans are still elevated. This means that it is still unclear to what extent companies' pricing behaviour has normalised. If it has not normalised, the effect on inflation of new cost increases could be considerable.

My overall assessment is that a tighter monetary policy is still necessary for inflation to stabilise close to the target within a reasonable period of time, but that it is sufficient to leave the policy rate unchanged at this meeting. Thanks to the improved inflation prospects, it is likely that the policy rate can be cut earlier than we had assumed in November. As described in the draft update, there is even a possibility that it may be cut during the first half of this year. On my part, however, it will require very clear signs of continuing favourable developments for inflation and continued actions in line with the inflation target from economic agents, including companies, before any discussion of rate cuts.

We wrote in the November Monetary Policy Report that lower inflation than expected in this situation was less of a problem than surprisingly high inflation. I

[1] See the special study "Prissättning hos svenska företag 2023" (Pricing among Swedish companies in 2023), National Institute of Economic Research.

still consider this to be the case. At the same time, the aim is to do what is necessary for inflation to come all the way down to the target and stabilise, without in the short term causing too great a damage to the real economy in the form of reduced production and employment. When choosing between different interest rate alternatives, we also need to take into consideration a broad set of indicators to assess the development of inflation and how well monetary policy is functioning.

The proposed decision also involves a further step towards a normalisation of the Riksbank's balance sheet, in that the pace of sales of government bonds increases. The sales proceeded according to plan during the autumn, with high demand from the market. Surveys also show that market participants perceive that the market for government bonds is functioning better.[2] But, as we have said before: It is the policy rate that is our primary tool for attaining low and stable inflation.

First Deputy Governor Anna Breman:

I support the proposal to leave the policy rate unchanged, to increase sales of government bonds and the monetary policy assessments presented in the draft Monetary Policy Update.

Monetary policy has contributed to lower inflationary pressures and firmly anchored inflation expectations. Within the course of a year, CPIF inflation has fallen from just over 10 per cent in December 2022 to 2.3 per cent in the latest outcome for December 2023. In the near term, fluctuations in energy prices are likely to lead to CPIF inflation increasing again while CPIF inflation excluding energy is expected to continue to fall. A contractionary monetary policy is required for inflation to stabilise sustainably at a low level. I therefore support the proposal to leave the policy rate unchanged.

I also support increasing sales of government bonds. The primary aim is a continued normalisation of the balance sheet. By making it easier for foreign investors to invest in Swedish assets and improving the functionality of the financial markets, the sales may also provide some support to the Swedish krona. The krona remains weak and any further weakening may make it more difficult to stabilise inflation.

At today’s meeting, I will focus my comments on the risk outlook and the monetary policy strategy. New information since the last meeting on the prospects for inflation is relatively positive, but at the same time we have increasing geopolitical risks, with a prolonged war in Europe and escalating tensions in the Middle East. To highlight risks, and the potential monetary policy

[2] See, for instance, the Financial markets survey Autumn 2023, Sveriges Riksbank.

response to different risks, alternative scenarios are helpful, but at today's meeting we have no new forecasts, no new policy-rate path, and no alternative scenarios. I would therefore like to discuss how we can weigh improved inflation prospects against worrying developments abroad that can rapidly break the positive trend.

Let me begin with the inflation prospects. The risk of inflation becoming entrenched at too high a level has declined. The outcomes and forward-looking indicators point to a development quite close to the alternative scenario in November with lower inflation. In addition, the labour market continues to weaken, which is cooling demand. The policy rate will probably be cut sooner than the November forecast indicated. Falling inflation and a lower policy rate in the medium term will strengthen households' purchasing power; the Swedish economy will pick up and the labour market will improve towards the end of the year.

This is our main scenario, but our monetary policy strategy must be prepared for setbacks and consider the long-term effects of inflation possibly being higher or lower than expected. If inflation stops falling, we can refrain from rate cuts or increase the policy rate further. This would probably happen in a situation where demand is already weak and the labour market is cooling. And this in turn could have long-term negative effects on the Swedish economy with rising unemployment and a deeper recession.

If we leave the policy rate unchanged and the inflation prospects are better than expected, we can cut the policy rate earlier or more than expected. In a situation where the policy rate is at a contractionary level and far from the lower bound, cuts could relatively quickly lead to higher demand, a stronger labour market and prevent deflation. In other words, with a policy rate at 4 per cent, the consequences of dealing with unexpectedly high inflation are more negative compared to unexpectedly low inflation. This suggests we should be patient. Unless the inflation prospects improve further and/or the real economy deteriorates considerably, we should keep the policy rate unchanged for some time going forward.

Furthermore, in addition to actual changes in the policy rate, expectations also play a role in how the economy evolves. The policy-rate expectations and inflation expectations of the market participants, households and companies are important. If these agents expect extensive policy-rate cuts in the near term, as some of them currently do, the financial conditions could become so expansionary that they contribute to higher demand even before the policy rate has been cut. This may happen, for example, as the result of a fall in market rates and a weakened krona, which could bring the decline in inflation to a halt.

Paradoxically, expectations of rapid rate cuts may require us to keep the policy rate at its current level for longer than otherwise would have been necessary.

In this context, I would like to stress inflation expectations and the link to companies' price-setting behaviour. Studies from the National Institute of Economic Research and the Riksbank suggest that many companies have been able to pass on cost increases, both from a weak krona and from higher producer prices, to a significantly greater extent than we have seen historically.[3] If this new behaviour persists, inflation may be more volatile going forward as small changes in companies' costs, such as disruptions in energy prices, freight prices or a temporary depreciation of the krona, have a greater impact on consumer prices. It is therefore important to monitor companies' price plans, which remain on an elevated level.

Allow me to summarise. Monetary policy is helping to reduce inflation and the conditions for a sustainable stabilisation of inflation have improved. I therefore support keeping the policy rate unchanged and I share the assessment that the policy rate can probably be cut earlier than in the November forecast. At the same time, I have highlighted the risk outlook and the need to be able to act effectively in turbulent times. A smooth return to low and stable inflation should not be taken for granted.

Governor Erik Thedéen:

Let me begin by briefly saying that I support the proposal to hold the policy rate unchanged at 4 per cent, and I support the wording of the draft Monetary Policy Update. Monetary policy needs to be contractionary for some time to ensure that inflation comes down and stabilises at the target.

I also support the proposal to increase the pace of government bond sales from SEK 5 to 6.5 billion per month. The purpose is to normalise the Riksbank's holdings of government bonds and to support an improvement in the functioning of the market for government bonds. So far, I assess that our sales have functioned well and that the volumes can therefore be increased somewhat.

Since the previous monetary policy meeting at the end of November, developments have been more or less as we anticipated. Economic activity in Sweden has continued to slow down, the labour market has become somewhat weaker, and inflation has continued to fall. In December, CPIF inflation was 2.3

[3] See, for example, the special study "Prissättning hos svenska företag 2023" (Pricing among Swedish companies in 2023), National Institute of Economic Research, A. Breman, "Inflation is falling, but risks remain", speech on 4 December 2023, Sveriges Riksbank and J. Ewertzh, M. Klein and O. Tysklind, "Price dynamics in Sweden: Insights from a new dataset", Economic Commentaries, no. 1, 2022, Sveriges Riksbank.

per cent. Underlying inflation measured in terms of the CPIF excluding energy was higher, 5.3 per cent, although it has also fallen recently, and more than expected.

My view is that the inflation dynamic is now going in the desired direction. This can be seen in the recent outcomes for various measures of both consumer prices and producer prices. In addition, short-term inflation expectations have fallen further. Wage growth is also still in line with the target. There are thus clear signs that we may be on the way into a new monetary policy phase. We are moving from a period of almost two years when the policy rate was raised to address the high inflation, and on some occasions by substantial amounts. However, in November last year we were able to leave the policy rate unchanged for the first time, as inflation showed clearer signs of falling back towards the target. In November, we had a bias towards further tightening possibly becoming necessary. I no longer perceive this to be the situation. It is very probable that the interest rate has peaked for this time, and eventually it should be possible to gradually ease monetary policy.

The main reason why I now consider there to be scope to cut the policy rate going forward is that inflation has been falling for some time, and the momentum in inflation – such as the outcomes over the past three to six months – shows that we are on the way to attaining the target of 2 per cent inflation. During both 2022 and the start of 2023, inflation was higher than our own forecast on several occasions. The forecasting errors created uncertainty, but our most recent forecasts of a fall in inflation were relatively accurate, which is illustrated in Figure 7 of the draft update. My assessment is that there is now a lower risk of inflation once again being much higher than expected, although individual outcomes may well vary. One could say that we are on slightly firmer ground now.

Last year, when inflation was far too high and difficult to forecast, at the same time as developments in the real economy were surprisingly positive, it was reasonable to have a clear focus on the high inflation. It is now clearer than it was for, say, just over six months ago, that the Swedish economy, and not least the labour market, is weakening. This means that companies' price-setting is now in an environment where it should be more difficult to raise prices than it was before. Over the coming months, we will thoroughly analyse a suitable point in time for the first policy rate cut and how the following easing will take place. In this assessment the inflation dynamic will of course be a central factor, but I will also give slightly greater weight to how activity in the Swedish economy is developing.

Our assessment of the monetary policy stance will be shown in the updated policy rate path that we will publish after our meeting in March. In the draft update at today's meeting we will merely observe that the possibility of the policy rate being cut during the first half of this year cannot be ruled out, given that the prospects for inflation remain favourable.

There is still a risk of setbacks with regard to both inflation and developments in the real economy, partly driven by the increasingly strained geopolitical situation. Russia's full-scale invasion of Ukraine can continue to affect, for instance, wheat and energy prices. Moreover, Russia’s hybrid warfare, for instance through cyber attacks on critical social functions, can have a negative impact on the European and Swedish economies. And the conflict in the Middle East has already affected the price of freight, for instance, and it could lead to even greater disruptions to supply chains.

Another risk for inflation is the development of the krona. This year the krona has again weakened somewhat, after strengthening at the end of 2023. This indicates that it is still difficult to analyse how the krona will develop. If the krona were to end up in a depreciating trend again, there is a risk that inflation might not fall back towards the target in line with our forecast. In that case, my view of when we can begin easing monetary policy would be affected. If the krona weakens once again, caution would indicate taking a wait-and-see stance with regard to monetary policy.

To summarise, I think that we are on firmer ground with regard to inflation, which seems to be reinforced by a similar development abroad. We should have seen the interest rate peak now, and there is some probability that we can ease monetary policy during the first half of the year. However, there is still considerable uncertainty with regard to future policy rate decisions and there is a risk of setbacks with regard to inflation and the inflation dynamic. Experiences of previous episodes of high inflation clearly show the risks that can arise if the central bank lowers its guard too soon. The work on stabilising inflation sustainably at the target is not yet over, and I am prepared to hold the policy rate at a contractionary level for a longer period of time, if this should prove necessary. Potential monetary policy easing will be carried out with caution, and with a constant vigilance regarding the risk of setbacks that could affect inflation.

§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 and government bond sales. The Riksbank sets the policy rate at 4 per cent, which means that it is held unchanged.
- to establish the Monetary Policy Update according to the proposal, Annex B to the minutes Monetary Policy Update,
- to publish the monetary policy decision with the reasons for it in a press release at 09.30 on Thursday 1 February 2024,
- to publish the minutes from today's meeting at 09.30 on Wednesday 7 February 2024.

This paragraph was confirmed immediately.

Minutes taken by

Björn Andersson Liza Tchibalina

Verified by

Erik Thedéen Anna Breman Per Jansson

Martin Flodén Aino Bunge

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

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