Monetary Policy Update

May 2024

Monetary policy discussion

Monetary policy and fading supply shocks have contributed to inflation now being close to the target. In March, CPIF inflation was 2.2 per cent, which was lower than the Riksbank's forecast. CPIF inflation excluding energy was 2.9 per cent, which was also lower than expected. Inflation expectations are firmly anchored and wage increases are moderate. Information received since the Monetary Policy Report in March reinforces the outlook for inflation remaining close to target also in the longer term.

When inflation approaches the target while economic activity is weak, monetary policy can be eased. The Executive Board has therefore decided to cut the policy rate by 0.25 percentage points to 3.75 per cent. If the outlook for inflation still holds, the policy rate is expected to be cut two more times during the second half of the year, in line with the March forecast.

However, the outlook for inflation is uncertain. There are risks that may cause inflation in Sweden to rise again, primarily linked to the strong US economy, geopolitical tension and the krona exchange rate. The adjustment of monetary policy going forward should therefore be characterised by caution, with gradual cuts to the policy rate.

Economic developments

Economic developments and inflation differ significantly between regions. The strength of the US economy has led to higher interest rates globally, despite subdued domestic demand in both the euro area and China. In China, inflation continues to be very low. Overall, the recent trend of stronger developments in the United States than in the euro area has continued at the beginning of the year.

The US economy has continued to perform strongly. This is partly explained by major fiscal stimulus. The GDP outcome for the first quarter of this year indicates strong growth in household consumption and business investment. However, in annualised terms, quarterly growth fell to 1.6 per cent, which was slightly lower than the Riksbank's forecast, due partly to weaker net exports. The labour market remains strong, although there are indications of some weakening.

The strong economic performance is affecting inflation in the United States. The decline in core inflation in the United States has stalled and is slower than in the euro area and Sweden (see Figure 1). CPI inflation excluding energy and food was 3.8 per cent in March, which was only marginally lower than at the end of 2023. At the same time, CPI inflation was 3.5 per cent. It is still mainly rents that are contributing to the high rate of inflation. PCE inflation, which is the Federal Reserve's preferred measure, and in which rents have lower weight, amounted to 2.7 per cent in March.

In the euro area, economic developments are weaker and core inflation is falling. After several quarters of more or less unchanged GDP, growth was 0.3 per cent in the first quarter, somewhat higher than the Riksbank's forecast. Unemployment was unchanged in March and is still at historically low levels. HICP inflation was unchanged at 2.4 per cent in April, in line with the Riksbank's forecast. HICP inflation excluding energy and food fell from 2.9 per cent to 2.7 per cent.

The Federal Reserve is still emphasising caution, while the ECB sees scope for looser monetary policy. At its most recent monetary policy meeting in early May, the Federal Reserve emphasised that the slow decline in inflation may delay a cut in the policy rate. However, the ECB has continued to communicate the possibility of a first rate cut in June.

Fewer policy rate cuts are expected abroad going forward. According to market pricing, approximately two rate cuts of 0.25 percentage points are expected from the Federal Reserve this year. This can be compared with three at the end of March, and six at the beginning of the year. According to expectations, the timing of the first cut has also been postponed. The ECB is expected to cut the rate two or three times this year, starting in the summer (see Figure 2).

Market rates have risen since March. The global upturn in interest rates has taken place against the backdrop of both higher expected policy rates going forward and higher inflation expectations. Market rates have risen more in the United States than in Europe.

The dollar has appreciated against other currencies. This appreciation is primarily explained by the strong US economy, which has resulted in expectations of fewer interest rate cuts by the Federal Reserve. This has led to the krona, like many other currencies, depreciating against the dollar. Since the Monetary Policy Report in March, the krona has also depreciated against the euro (see Figure 3).

There is war in Europe and the geopolitical risks are substantial due to the escalated conflict in the Middle East. Reactions in financial markets since March have so far been relatively minor. The oil price is overall slightly lower. If geopolitical tension escalates, it can lead to supply shocks, rising global market prices and ultimately higher Swedish inflation. At the same time, greater unease among households and businesses in this type of situation could soften demand and counteract the increase in inflation.

Swedish GDP growth has been weak but is expected to rise gradually. The GDP indicator points to low growth in the first quarter, in line with the March forecast (see Figure 4). However, growth is expected to strengthen going forward. Falling inflation means higher real wages, which helps to strengthen household purchasing power. Following a long period of weak consumption, there are also signs of rising optimism among households. Businesses are also expecting stronger economic activity going forward. This development is in line with the March forecast.

The labour market continues to weaken. Employment continued to decline during the first quarter of 2024 and unemployment rose to 8.3 per cent, which was somewhat higher than the March forecast. Indicators such as newly registered job openings continued to decline significantly in March, while the number of redundancy notices are relatively high. The number of bankruptcies is still at a high level. Overall, this points to higher unemployment in the period ahead (see Figure 4).

The average mortgage rate to households seems to have peaked and is expected to fall gradually going forward. Annual credit growth to the business sector remains negative and the households' borrowing growth rate is still around historically low levels. The transmission of monetary policy to the interest rates faced by Swedish households and businesses is working as expected.

In March, inflation continued to fall and was lower than expected. CPIF inflation was 2.2 per cent, and CPIF inflation excluding energy was 2.9 per cent (see Figure 5). Compared with the March forecast, the outcome was 0.5 percentage points lower for the CPIF and 0.4 percentage points lower for the CPIF excluding energy. The decline was broad among the sub-groups and prices of both goods and services increased more slowly than expected.

Forward-looking indicators suggest a continued fall in inflation. Price developments in the shorter term remain subdued, and are now slightly below 2 per cent in annualised terms (see Figure 6). According to the National Institute of Economic Research Economic Tendency Survey, fewer and fewer companies are planning to raise prices (see Figure 7). Long-term inflation expectations are well anchored around the target (see Figure 8).

Wages continue to increase at a moderate pace. The most recent outcome, for February, was 4.2 per cent according to preliminary statistics. Wage increases outside central agreements have remained low in a historical perspective.

There are risks that may challenge the favourable development of inflation. Increasing geopolitical tension could lead to higher inflation globally and in Sweden. If the strong developments in the United States continue, the Swedish krona could depreciate even further and lead to higher import prices for businesses. However, the effect on inflation depends on their pricing behaviour. It is uncertain to what extent they can continue to pass on the increased costs to consumer prices in a weaker economic situation. As inflation now falls from very high levels, there is also more general uncertainty on both the up- and downside, something well illustrated by developments in the United States.

Policy rate cut by 0.25 percentage points to 3.75 per cent

Monetary policy has been adjusted according to the outlook for inflation. After very high inflation and rapid interest rate increases from April 2022 to September 2023, there were signs during the autumn that inflationary pressures were easing. The policy rate has been held unchanged at 4 per cent since September, and the outlook for inflation has gradually improved. Following the monetary policy meeting in March, the Executive Board communicated that the policy rate could probably be cut in May or June.

Inflation has continued to fall and is now close to 2 per cent. Inflation excluding energy prices is also falling but it is slightly higher, just below 3 per cent. Forward-looking indicators point to inflation remaining close to target also in the slightly longer term. When inflation approaches the target and economic activity is weak, monetary policy can be eased.

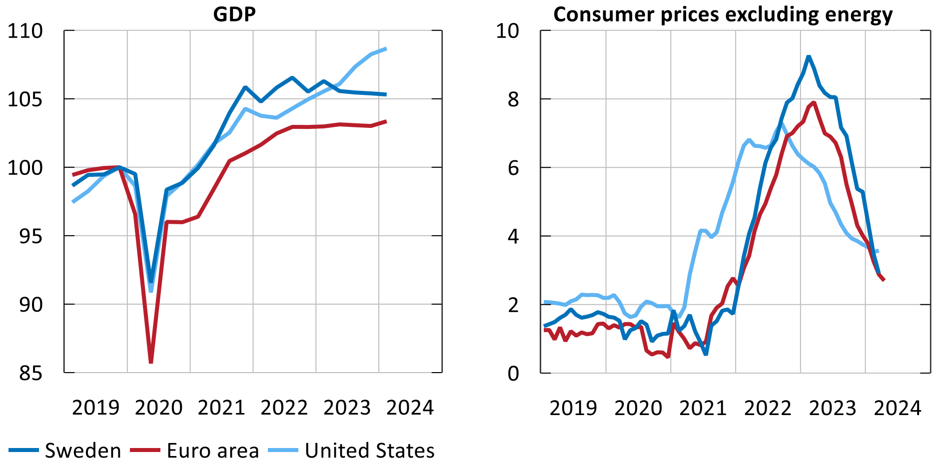
The Executive Board has therefore decided to cut the policy rate by 0.25 percentage points to 3.75 per cent. New information suggests that CPIF inflation may temporarily undershoot the target slightly later this year, but it has not changed the overall outlook for inflation in the coming years. If this outlook still holds, the policy rate could be cut two more times during the second half of the year, in line with the March forecast.

The inflation outlook is uncertain and the adjustment of monetary policy should be characterised by caution. A number of risk factors, primarily linked to international developments and the krona exchange rate, can cause inflation in Sweden to rise again. Moreover, rapid and large rate cuts could lead to a sharp increase in demand again and reignite inflation. This suggests monetary policy should be adjusted gradually.

Figures

Figure 1. GDP and inflation excluding energy

Index 2019 Q4=100 (left) and annual percentage change (right)

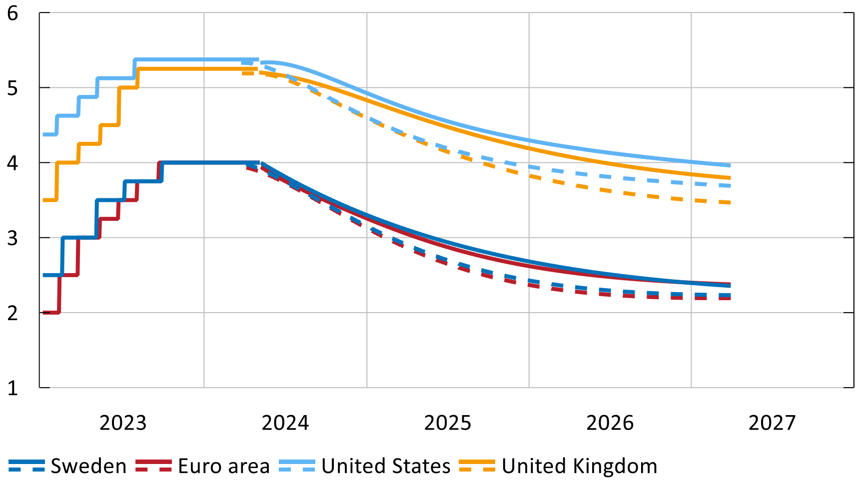


Note. The latest outcome for Sweden (Q1 2024) is based on Statistics Sweden's GDP indicator (left). Refers to the CPIF excluding energy for Sweden, the HICP excluding energy for the euro area and the CPI excluding energy for the US (right).

Sources: Eurostat, US Bureau of Labor Statistics and the Statistics Sweden.

Figure 2. Policy rates and policy rate expectations according to market pricing

Per cent

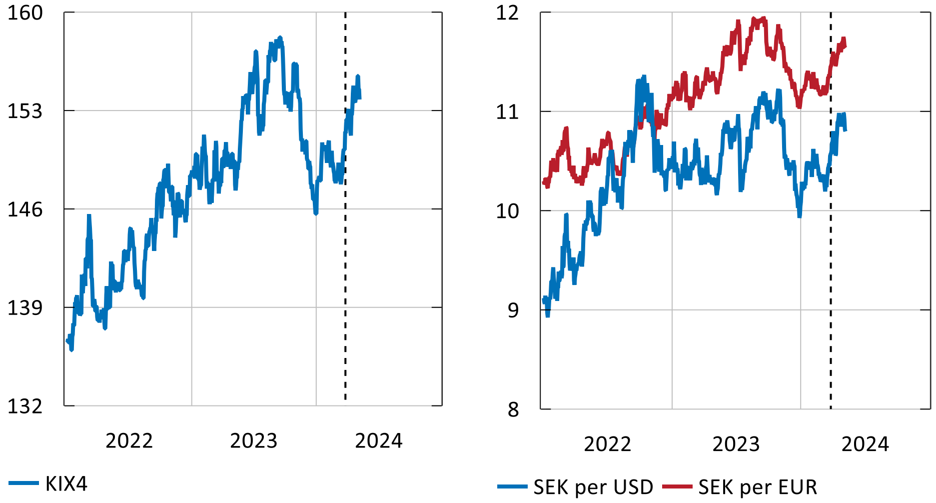


Note. The figure shows policy rates and market-based expectations of future policy rates. Solid lines represent expectations on 6 May 2024. Dashed lines represent expectations immediately prior to the monetary policy meeting in March.

Sources: National central banks and the Riksbank.

Figure 3. Nominal exchange rate against the KIX4 index, as well as against the US dollar and euro

Index, 18 November 1992 = 100 (left), and daily listings (right)

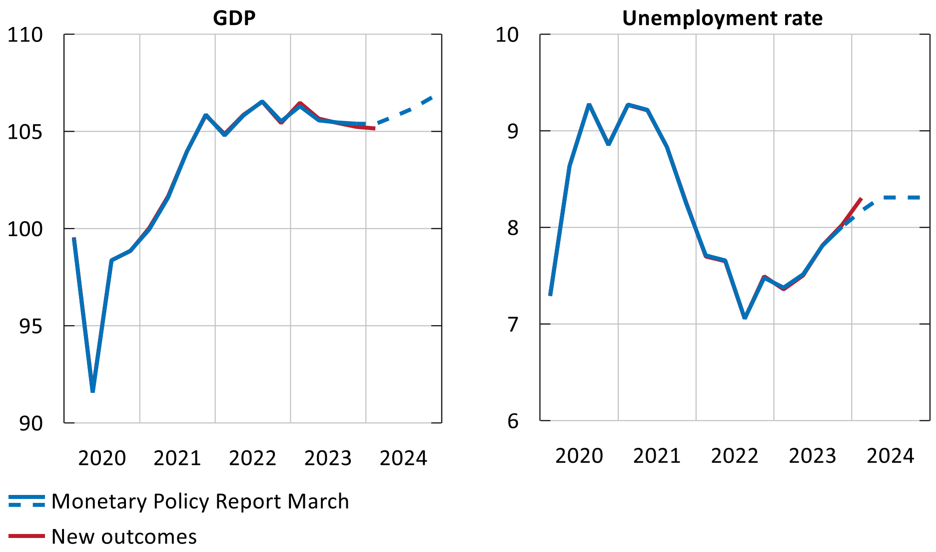


Note. The KIX4 (krona index) is a weighted average against the US dollar, the euro, pound sterling and the Norwegian krone. A higher value indicates a weaker exchange rate. The dashed line marks the date of the monetary policy meeting in March.

Sources: Macrobond Financial AB and the Riksbank.

Figure 4. GDP and unemployment in Sweden

Index 2019 Q4= 100 (left) and percentage of the labour force, aged 15–74 years (right)

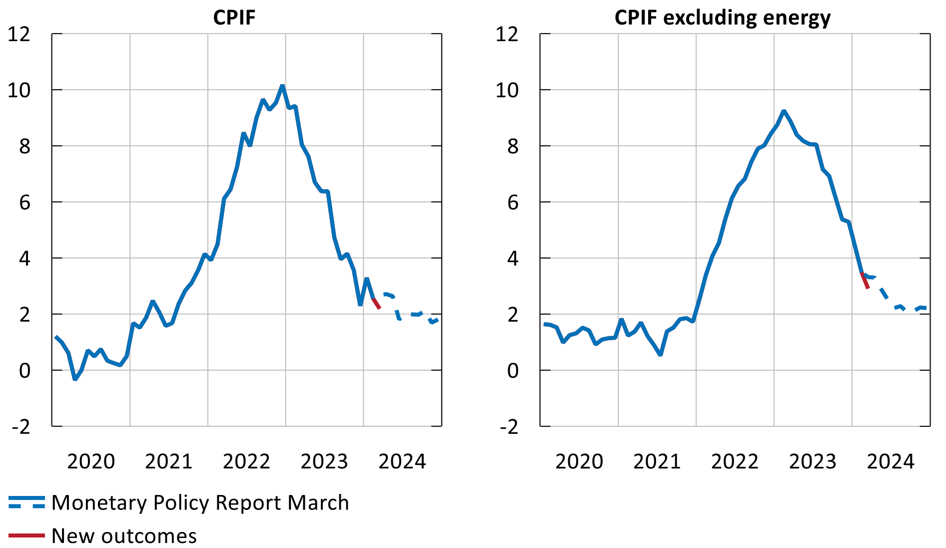


Note. Seasonally adjusted data. Solid blue lines and dashed blue lines refer to outcomes and forecasts at the monetary policy meeting in March. Red lines refer to new outcomes since then.

Sources: Statistics Sweden and the Riksbank.

Figure 5. The CPIF and the CPIF excluding energy

Annual percentage change

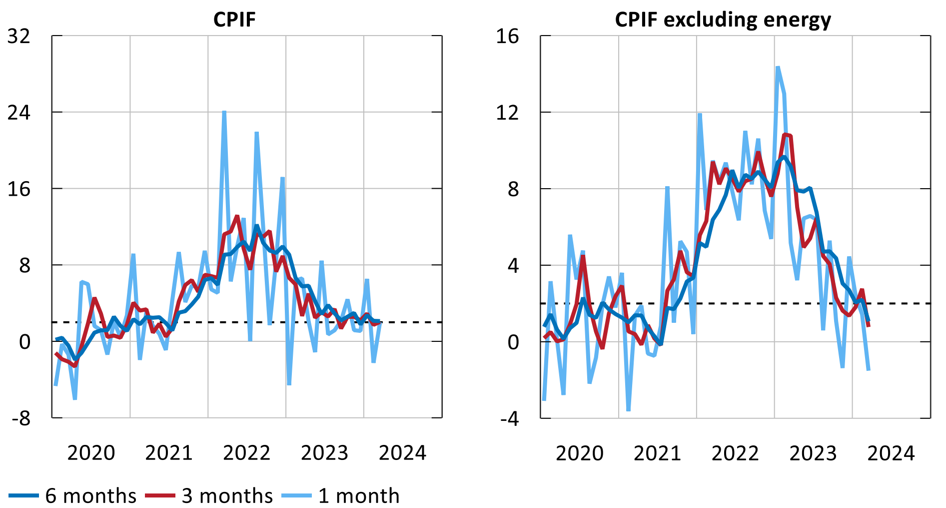


Note. Solid blue lines and dashed blue lines refer to outcomes and forecasts at the monetary policy meeting in March. Red lines refer to new outcomes since then.

Sources: Statistics Sweden and the Riksbank.

Figure 6. The CPIF and the CPIF excluding energy, short-term rates of change

1-, 3- and 6-month changes, annualised

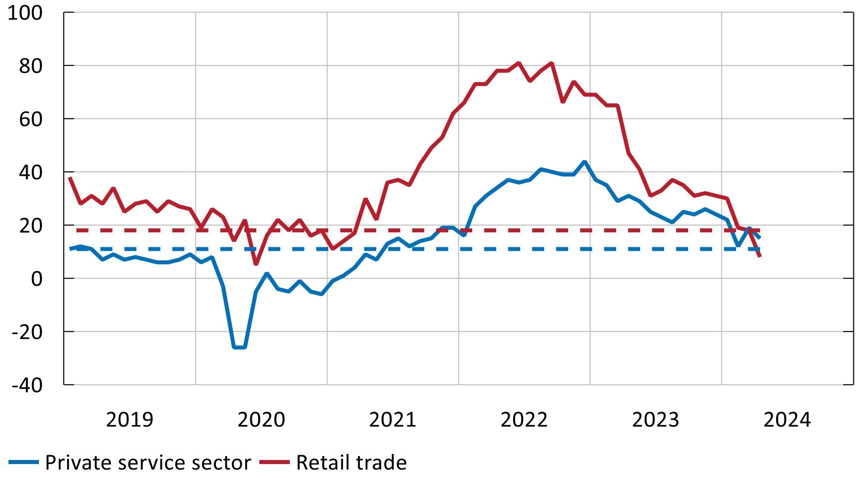


Note. Seasonally adjusted data.

Sources: Statistics Sweden and the Riksbank.

Figure 7. Price plans in the Economic Tendency Survey

Net figures

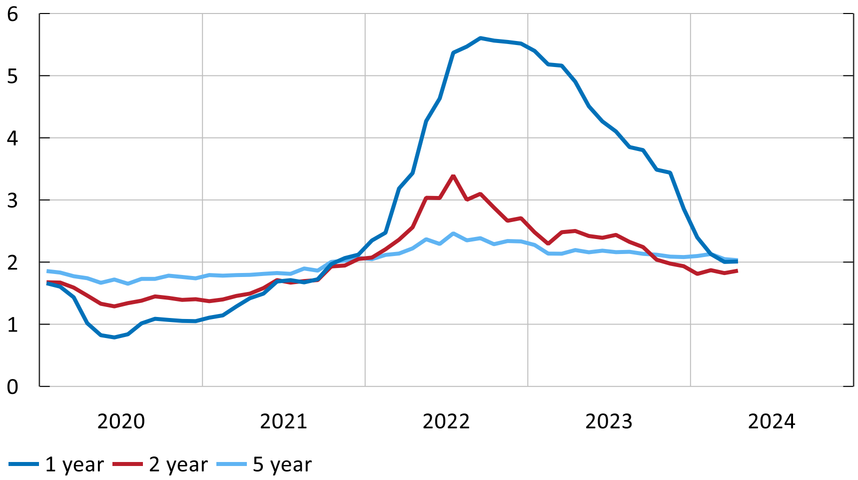


Note. The figure shows net balances of how many businesses responded that they plan to increase their prices compared with how many plan to reduce them in the coming three months. Seasonally adjusted data. The dashed lines represent the average for the period 2000–2024.

Source: National Institute of Economic Research.

Figure 8. Inflation expectations

Per cent



Note. Expectations refer to the CPI. Money market participants.

Source: Kantar Prospera.

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