Monetary Policy Update

August 2024

SVERIGES RIKSBANK

Monetary policy considerations

Inflation has continued to fall and the prospects for inflation being in line with the target going forward are good. Long-term inflation expectations are signalling strong confidence in the target and wage increases are moderate.

Inflation has developed as expected and economic activity is weak. The Executive Board has therefore decided to cut the policy rate by 0.25 percentage points to 3.5 per cent, in line with the June forecast.

Over the year, inflation has deviated less and less from the target of 2 per cent. At the same time, various indicators, such as producer prices and company pricing plans, have continued to imply that inflationary pressures are compatible with the target. All of this reinforces the picture of inflation stabilising close to the target and it indicates that the risk of inflation becoming too high again has declined significantly. Moreover, new information since the Monetary Policy Report in June indicates that the growth outlook in Sweden and abroad is somewhat weaker than in the most recently published forecast.

In light of this, the Executive Board assesses that the policy rate can be cut somewhat faster than was assessed in June. If the inflation outlook remains the same, the policy rate can be cut two or three more times this year.

However, the outlook for inflation and economic activity is uncertain. There are risks linked, for instance, to the geopolitical situation, economic activity in Sweden and abroad, and the krona exchange rate that can lead to a different outcome for inflation, and thereby a different monetary policy.

Economic developments

The global growth outlook has become somewhat weaker than expected. The June Monetary Policy Report assumed increasing growth this year. However, outcome data and indicators for the manufacturing industry in particular and developments in the labour market are somewhat weaker overall than was anticipated. This raises questions regarding future economic developments.

The geopolitical situation is still tense. The war in the wake of Russia’s invasion of Ukraine is continuing, and the conflicts in the Middle East have escalated during the summer. In addition, there are political proposals that entail increased protectionism, which could hamper economic developments. Despite the geopolitical tensions, prices of oil and other commodities have fallen somewhat during the summer. Freight prices for transports from Asia to Europe rose during the spring, but are at roughly the same level as in June.

The US economy shows signs of slowing down and inflation is falling. GDP rose more than expected during the second quarter of this year, but indicators point to a weaker development going forward. Not least, the US labour market has slowed down further. CPI inflation has continued to fall and was 2.9 per cent in July. Wage growth has also slowed down, which indicates lower inflationary pressures going forward.

Inflation hasnot fallen as fast in the euro area as in the United States recently. In July, HICP inflation in the euro area was 2.6 per cent. The rate of increase in service prices is still relatively high and wages are rising rapidly. GDP rose by 0.3 per cent during the second quarter, in relation to the previous quarter (see Figure 1). However, developments within the euro area differ clearly. For instance, GDP fell somewhat in Germany. Household confidence has strengthened, but indicators for the business sector present a more mixed impression. Unemployment is still low, but companies' recruitment plans fell clearly in July.

Several central banks have cut their policy rates. The ECB left its policy rate unchanged at 3.75 per cent in July, after an initial cut in June. The Federal Reserve left the interval for its policy rate unchanged at 5.25 to 5.5 at its meeting in July. They signalled that a preliminary cut could come at the next meeting, depending on how inflation and the labour market develop. Since the monetary policy meeting in June, the central banks in the United Kingdom, Canada and New Zealand have cut their policy rates. The central banks in Norway and Australia have left their policy rates unchanged, while the Bank of Japan has raised its policy rate.

The market is expecting policy rates abroad to be cut at a faster pace. Expectations of the major central banks' policy rates have varied considerably over the year. According to current market pricing, both the ECB and the Federal Reserve are expected to cut their policy rates several times before the end of 2024, which is more than was expected in June (see Figure 2). Expectations of the number of cuts by the Federal Reserve this year have increased since June, from almost two to almost four.

Developments in the financial markets have been characterised by substantial turbulence. The equity market has shown major fluctuations, which is based partly on increased uncertainty as to how central banks will act, and the strength of economic activity in the United States. The concern over weaker economic activity has led to lower interest rates, especially in the United States. The rate on a US two-year government bond has fallen by around 0.6 percentage points since the monetary policy meeting in June. At the same time, risk premiums on the credit market have not been affected to any great extent.

Swedish GDP fell during the second quarter of 2024. The outcome was weaker than the forecast in June (see Figure 3). The household confidence indicators point to rising optimism among households regarding both their own finances and the Swedish economy one year ahead, but monthly outcomes for consumption during the second quarter still indicate a weak development. Confidence indicators for the business sector point to growth remaining weak during the third quarter.

Developments in the labour market are subdued. Unemployment was unchanged at 8.3 per cent in the second quarter of this year, and thus become somewhat lower than expected (see Figure 3). Employment increased more than usual in June, but the outcomes in the summer months should be interpreted with caution. Labour market indicators point to relatively weak development in the labour market in the near term, but unemployment is not expected to rise much further.

Sweden is in a mild recession. GDP has been more or less unchanged since the end of 2021. It is primarily the interest-sensitive parts of the economy, such as household consumption and housing investment, that have been weak. The employment rate is high, but unemployment has risen by a good 1 percentage point in the last two years. Resource utilisation is assessed to be slightly lower than normal.

Short-term mortgage rates have continued to fall in line with short-term market rates. This has contributed to somewhat lower interest costs for households. At the same time, the demand for credit remains low in a historical perspective.

The krona exchange rate is at around the same level as at the previous monetary policy meeting. After the Monetary Policy Report in June, the krona weakened against both the US dollar and the euro, and then strengthened again by almost the same amount (see Figure 4). The development of the krona is similar to that of other small currencies.

Inflation has continued to fall. CPIF inflation was 1.7 per cent in July, which was 0.1 percentage point lower than the forecast in the June Monetary Policy Report. When energy is excluded, inflation was 2.2 per cent, in line with the forecast (see Figure 5). Over the past year, the rate of increase in both goods and service prices has shown a falling trend. Price changes measured over periods shorter than one year are on the whole close to 2 per cent (see Figure 6).

Wages are increasing somewhat more slowly compared to recent quarters. In May, wages rose by 3.8 per cent, compared with the same month in the previous year, according to preliminary statistics. The slower rate of increase was in line with the profile of the central wage agreements and the Riksbank's forecast in June. The fact that inflation has fallen means that real wages are now rising (see Figure 7).

Indicators point to inflationary pressures that are compatible with the inflation target. According to the National Institute of Economic Research's Economic Tendency Survey, companies’ pricing plans are close to their historical average (see Figure 8). Producer prices are developing at a moderate pace. Long-term inflation expectations are well anchored around the target (see Figure 9).

CPIF inflation is expected to remain just below 2 per cent for a further couple of months. This is because energy prices are lower this year than they were last year, and that new information supports the forecast from June that inflation adjusted for energy prices will be close to 2 per cent.

Policy rate is cut to 3.5 per cent

Over the year, monetary policy has been gradually adjusted to an improved inflation outlook. In connection with the monetary policy meeting in June, the Executive Board held the policy rate unchanged at 3.75 per cent, and communicated that if the inflation outlook holds, the policy rate could be cut two or three times during the second half of the year.

The Executive Board has decided to cut the policy rate by 0.25 percentage points to 3.5 per cent. Since the June Monetary Policy Report, inflation has continued to fall in line with the forecasts. The conditions for an inflation rate in line with the target also going forward are good. Long-term inflation expectations are signalling strong confidence in the target and wage increases are moderate. At the same time, economic activity is weak.

Over the year, inflation has deviated less and less from the target of 2 per cent. Short-term price changes have also increasingly been close to 2 per cent. Various indicators, such as producer prices and company pricing plans, are continuing to imply that inflationary pressures are compatible with the target. All of this reinforces the picture of inflation stabilising close to the target and it implies that the risk of inflation becoming too high again has declined significantly. At the same time, new information implies that the growth outlook in Sweden and abroad is somewhat weaker than in the most recent forecast.

The policy rate can be cut a further two or three times before the end of the year if the inflation outlook still holds. In light of an increasingly favourable inflation outlook and the weak economic activity, the Executive Board assesses that the policy rate can be cut somewhat faster than was assessed in June.

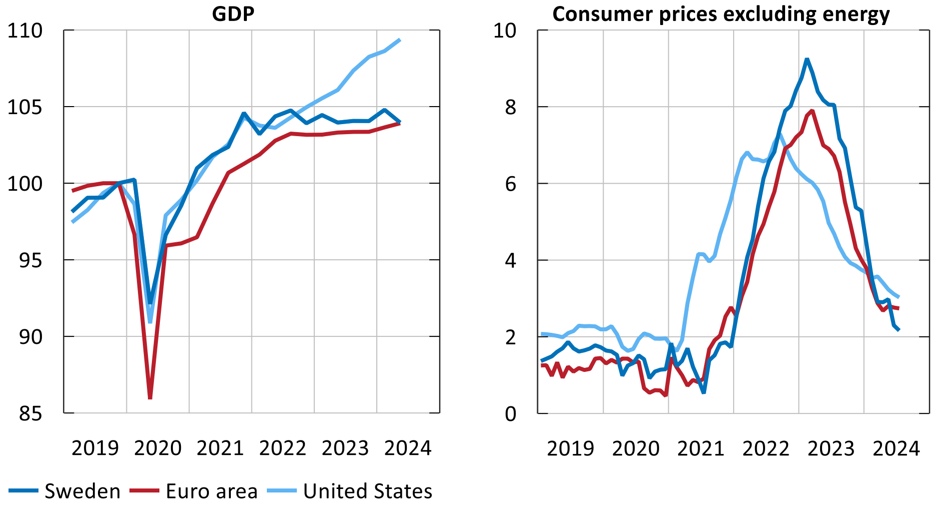
There are risks that can cause the inflation outlook to change rapidly. An increase in geopolitical tension could trigger new supply shocks and lead to either higher or lower inflation. It is difficult to assess economic activity, and it can become weaker or stronger than expected. There also remain questions marks regarding economic policy in both the United States and Europe. Companies' price-setting behaviour is still very important with regard to inflation. A price-setting behaviour that deviates from the historically normal pattern can entail higher or lower inflation.

The uncertainty emphasises that the adjustment of monetary policy needs to be gradual. A gradual adjustment of monetary policy contributes to stability and predictability when households and companies need to make financial decisions. New forecasts for inflation and economic activity, and a new policy rate path, will be published in connection with the monetary policy meeting in September. If the inflation and growth outlook change, the direction of monetary policy will be adjusted.

Figures

Figure 1. GDP and consumer prices excluding energy

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

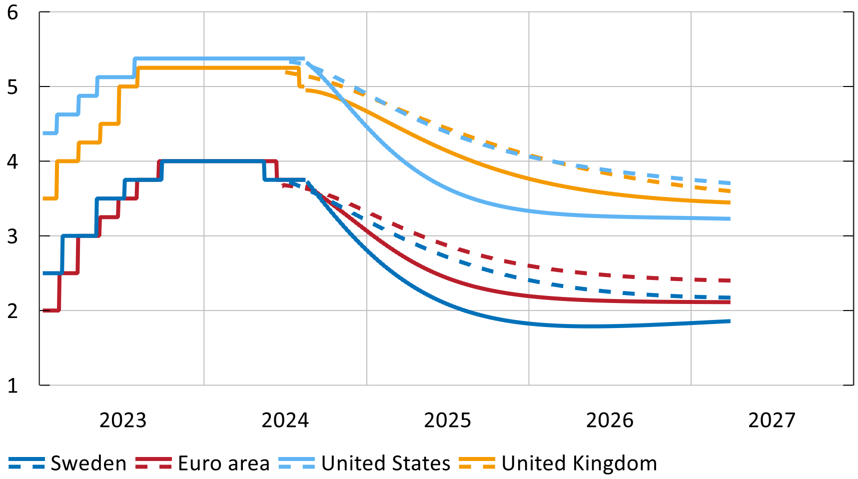


Note. The final outcome of GDP for Sweden (2024 Q2) is based on Statistics Sweden's GDP indicator (left). Refers to CPIF excluding energy for Sweden, HICP excluding energy for the euro area and CPI excluding energy for the USA (right).

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

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

Per cent

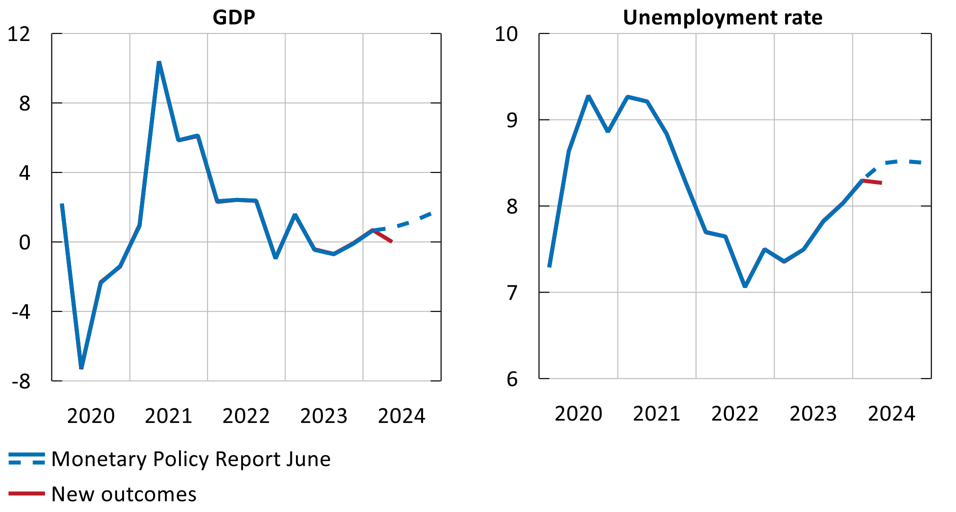


Note. The figure shows policy rates and market-based expectations of future policy rates. Solid lines represent pricing on 16 August 2024 and dashed lines refer to pricing immediately prior to the Monetary Policy Meeting in June.

Sources: National central banks and the Riksbank.

Figure 3. GDP and unemployment in Sweden

Annual percentage change (left) and percentage of labour force, 15–74 years (right)

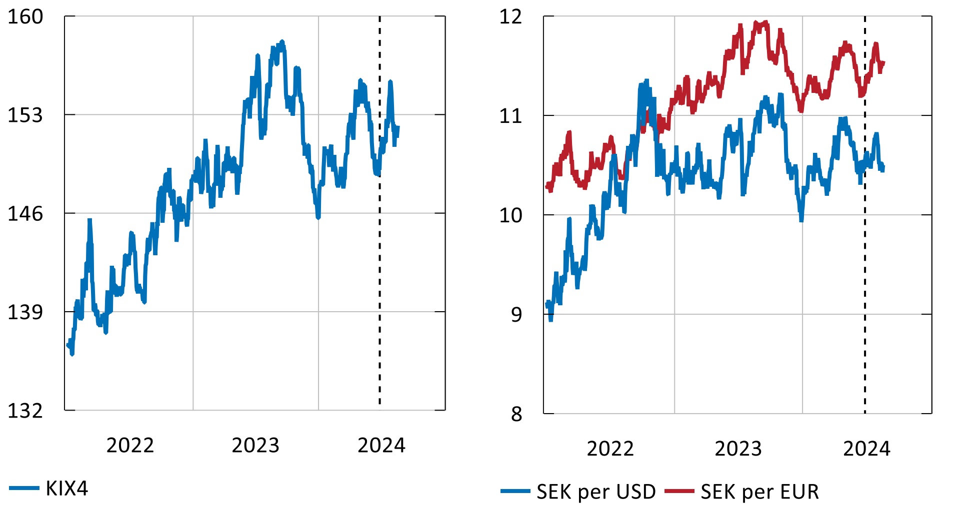


Note. GDP is calendar-adjusted data and outcomes for the second quarter according to the GDP indicator. Unemployment is seasonally adjusted data. Solid blue line and dashed blue line refer to outcome and forecast respectively at the June monetary policy meeting. Red line refers to new outcomes since then.

Sources: Statistics Sweden and the Riksbank.

Figure 4. Nominal exchange rate against KIX4 index, as well as against the US dollar and euro

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

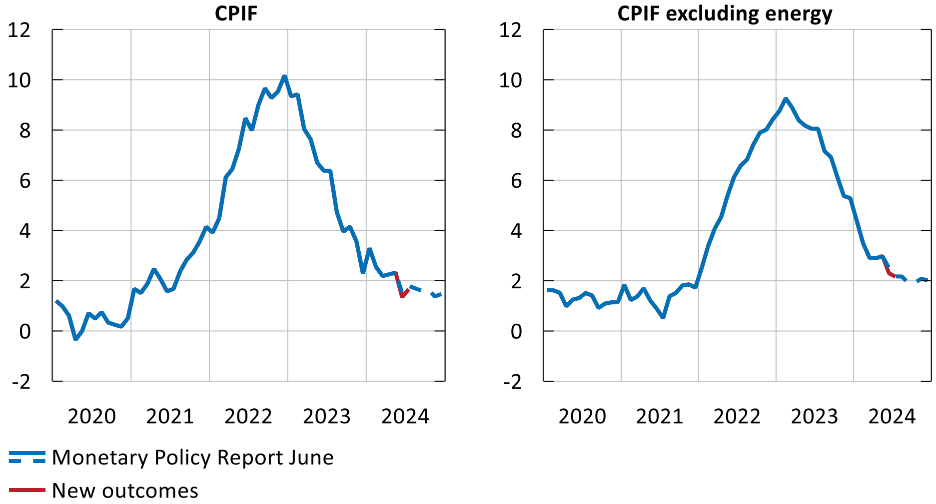


Note. The KIX4 (krona index) is a weighted average against the US dollar, euro, pound sterling and Norwegian krone. A higher value indicates a weaker exchange rate. The dashed line marks the date of the monetary policy meeting in June.

Sources: Macrobond Financial AB and the Riksbank.

Figure 5. The CPIF and the CPIF excluding energy

Annual percentage change

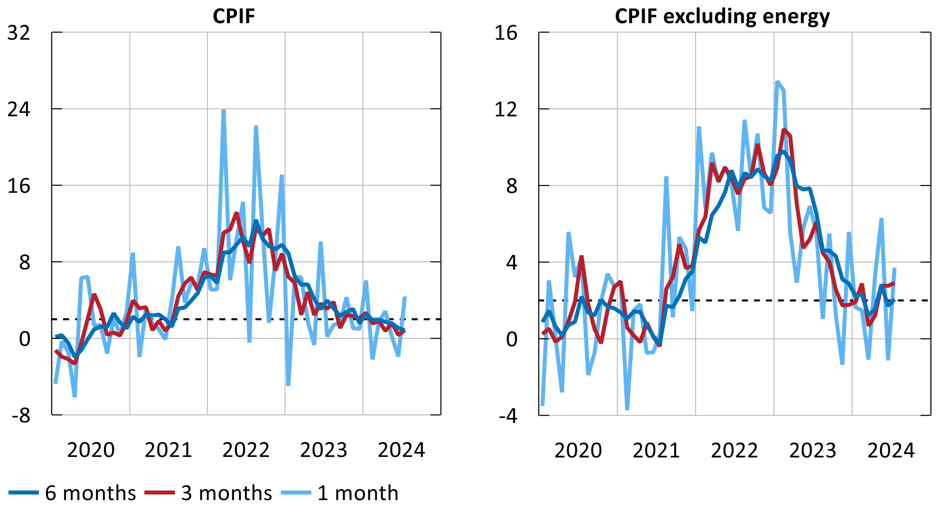


Note. Solid blue line and dashed blue line refer to outcome and forecast respectively at the June monetary policy meeting. Red line refers to new outcomes since then.

Sources: Statistics Sweden and the Riksbank.

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

1, 3 and 6-month changes, calculated as an annual rate in per cent

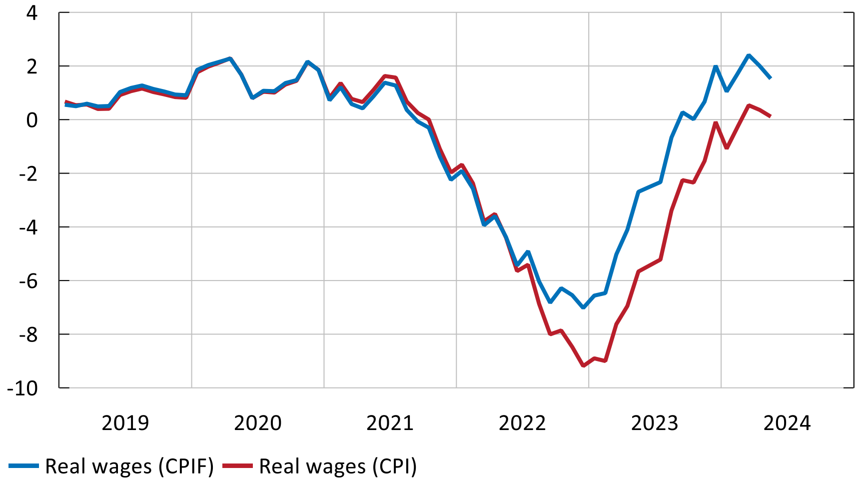


Note. Seasonally adjusted data. The dashed line marks two percent.

Sources: Statistics Sweden and the Riksbank.

Figure 7. Real wages

Annual percentage change

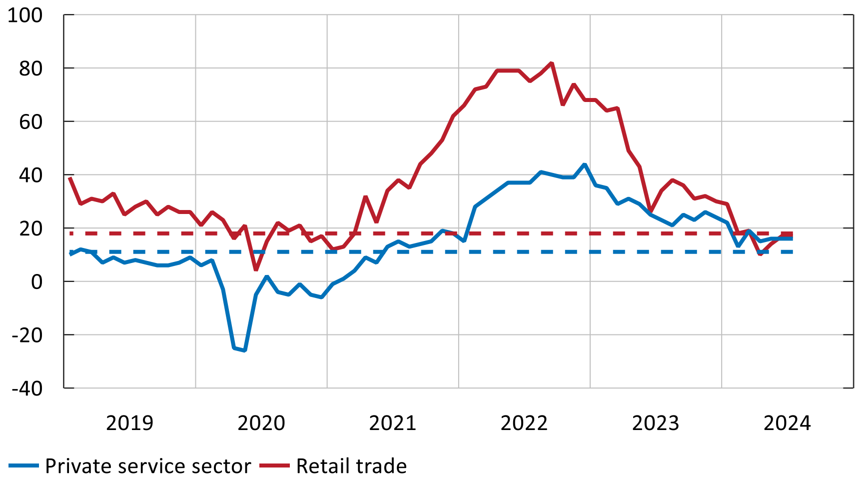


Note. Real wages are calculated as the difference between the rate of wage growth and the annual percentage change in the CPI and CPIF. Data on the rate of wage growth is preliminary and refers to the National Mediation Office's forecasts of the final outcomes.

Sources: Statistics Sweden, the National Mediation Office and the Riksbank.

Figure 8. Pricing plans in the Economic Tendency Survey

Net figures

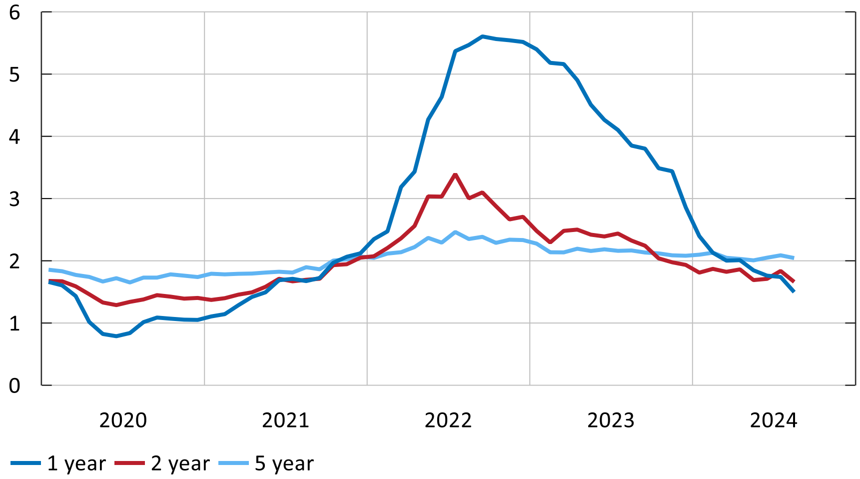


Note. The figure shows net balances of how many businesses responded that they plan to increase their prices compared with how many plan to reduce them in the coming three months. Seasonally adjusted data. The dashed lines represent the average for the period 2000-2024.

Source: National Institute of Economic Research.

Figure 9. Inflation expectations

Per cent



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

Source: Kantar Prospera.

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