Monetary policy minutes

August 2024

MONETARY POLICY MINUTES

Executive Board, No. 5

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PRESENT:	Erik Thedéen, Chair Anna Breman Per Jansson Aino Bunge Anna Seim --- Bo Broman, Chair, General Council of the Riksbank Tomas Eneroth, Vice Chair, General Council of the Riksbank --- Lena Arfalk Erik Berggren Vesna Corbo Charlotta Edler Mattias Erlandsson Susanna Grufman Anders Gånge Marie Hesselman Iida Häkkinen Skans Jens Iversen Matilda Kilström Anders Kvist Stefan Laséen Ann-Leena Mikiver Olof Sandstedt Åsa Olli Segendorf Ulrika Söderberg --- Buster Carlsen (§1–3a) Maria Johansson (§1–3a)

It was noted that Erik Berggren and Iida Häkkinen Skans would prepare the draft minutes of the monetary policy meeting.

§3 a. Economic developments

Market developments since the last monetary policy meeting

Buster Carlsen, market economist at the Markets Department, began by presenting developments in the financial markets since the previous monetary policy meeting in June. During the summer, US inflation has continued to fall and the US central bank (the Federal Reserve) held the target interval for its policy rate unchanged at its most recent meeting at the end of July. The central bank's statement emphasised that developments in the labour market will play an important role for the future monetary policy stance. After the decision, labour market data for the United States in July was published, showing both higher unemployment and somewhat weaker employment in relation to the previous month. The financial markets interpreted the outcome as meaning that the risk of a clear slowdown in the US economy had increased. Government bond yields fell heavily as a result of expectations of a lower policy rate. However, market turmoil over a potential US recession has declined since then, partly as a result of statistics showing continued good growth. The market has priced a certain probability that the Federal Reserve will cut the policy rate by 0.5 percentage points in September, but a cut of 0.25 percentage points is considered more probable. Persistent inflation above 2 per cent in the euro area contributed to the European Central Bank (ECB) leaving its policy rates unchanged in July. However, the market is pricing a cut at the next meeting in September.

The Bank of Japan's surprising rate increase at the end of July, and signs of a weaker US labour market at the beginning of August led to large stock market falls. Volatility measures on the stock market rose to levels that have not been seen since the pandemic. For the broad equity index in the United States this erased large parts of the spring upturns, and stock markets in Japan noted the largest fall in one day since 1987. The stock markets have now recovered from the falls. The turbulence around the turn of the month also created substantial fluctuations on the foreign exchange markets. The krona weakened in July, but has strengthened again, and the exchange rate is now at around the same level as at the June monetary policy meeting.

Ukraina's ongoing counter-offensive in Russia since the beginning of August has led to rising gas prices. The conquered area contains important infrastructure for natural gas deliveries to Europe.

Market participants are expecting the Riksbank to cut the policy rate by 0.25 percentage points at today's meeting, which is also reflected in the pricing of relevant forward contracts. With regard to the remaining decisions during the year, however, opinions are divided regarding the Riksbank's monetary policy. Forward contracts indicate expectations that the Riksbank will cut the policy rate at every remaining meeting this year, while several economists and analysts instead predict three cuts, of 0.25 percentage points each time.

Financial stability – current situation and risks

Olof Sandstedt, Head of the Financial Stability Department, described the situation in the Swedish financial system. The financial system is functioning well, but there is still considerable uncertainty as interest rates are continuing to put pressure on households and companies.

The major banks' large exposure to the highly-indebted property companies is still a vulnerability, but the situation for property companies has recently improved somewhat. Financing conditions on the bond market are more advantageous and more property companies have been able to issue bonds. However, there are risks linked to property companies' operations. For instance, vacancies in office properties are at elevated levels and have continued to rise. All in all, many property companies need to continue reducing their risks. Moreover, company bankruptcies are expected to remain at a high level in the near term. This means that there is still a risk that the banks' loan losses may increase.

The major Swedish banks are assessed to have a good starting position with continued high profitability and low loan losses during the second quarter and headroom down to the capital requirements. The recent volatility on the financial markets has not had any significant consequences for the banking sector's liquidity and financing.

The current monetary policy drafting process

Matilda Kilström, senior economist 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 judges will gain majority support in the Executive Board at today's meeting. The basis for today's decision has been discussed by the Executive Board at drafting meetings on 12 and 13 August. The draft Monetary Policy Update was discussed at a drafting meeting on 14 August.

The assessment in the June Monetary Policy Report was that inflation was close to the target level. The essentially favourable development of inflation, the somewhat weaker economic activity and a stronger exchange rate justified a slight downward adjustment of the policy rate forecast. However, the uncertainty over the inflation outlook motivated a continued gradual adjustment of monetary policy.

A central question in the drafting process has been how new information has affected the inflation outlook and growth prospects in Sweden and abroad. Other questions discussed are whether and if so, how the risk outlook for international economic activity and the development of inflation in Sweden has shifted.

Developments since the report in June provide further confirmation that inflation will stabilise close to the inflation target. In July, CPIF inflation was 1.7 per cent, which was 0.1 percentage points lower than expected. Energy prices are lower than last year and are making a negative contribution to inflation, but even excluding energy prices, inflation is falling. In July, CPIF inflation excluding energy was 2.2 per cent, in line with the forecast. Seen over the past year, the rate of increase in both goods and service prices has shown a falling trend. Price changes measured over shorter periods are generally close to 2 per cent.

Forward-looking indicators also point to inflationary pressures that are compatible with the inflation target. The National Institute of Economic Research's Economic Tendency Survey shows that companies’ pricing plans are now close to their historical averages and producer prices are showing moderate development. Long-term inflation expectations are firmly anchored at the target, and the favourable development of inflation indicates that the risk of inflation once again becoming too high has declined further.

After an initial weakening, the krona exchange rate is now around the same level as at the previous monetary policy meeting. This development is similar to that of other small currencies.

Sweden is in a mild recession and the developments in the labour market are subdued. Compared with the assessment in June, new data indicate somewhat weaker growth prospects. It is primarily the interest-rate sensitive parts of the economy, such as household consumption and housing investment, that are weak, although households’ confidence indicators point to increasing optimism.

The global growth prospects also look somewhat weaker than in the assessment in June. The US economy is showing signs of slowing down, with a clearer slowdown in the labour market and a continued fall in inflation. An increased uncertainty over the strength of economic activity in the United States has contributed to lower interest rates in several countries, but primarily the United States. Developments in the financial markets have been characterised by substantial turbulence. Inflation in the euro area has not fallen as quickly as in the United States recently.

Expectations of the major central banks’ policy rates have varied considerably over the year, and compared with June the market is now expecting that policy rates abroad will be cut at a faster pace. According to current market pricing, both the Federal Reserve and the ECB are expected to cut their policy rates several times during the remainder of the year. The change is most evident with regard to the Federal Reserve, where market pricing has shifted from expectations of almost two to just under four policy rate cuts. In Sweden, too, more policy rate cuts are expected now than in June.

The proposal for a monetary policy decision that the Monetary Policy Department judges will gain a majority in the Executive Board at today's meeting is described in Annex A to the minutes. The proposal entails cutting the policy rate by 0.25 percentage points to 3.5 per cent at today's meeting. If the outlook for inflation stays the same, the policy rate can be cut two or three more times during the second half of the year, which is somewhat faster than was forecast in June. The Riksbank's asset holdings will continue to decrease through maturities and the sales of government bonds decided on in January.

§3b. The economic situation and monetary policy

Deputy Governor Aino Bunge:

I support both the proposal to cut the policy rate by 0.25 percentage points to 3.5 per cent at this meeting and the assessments made in the draft Monetary Policy Update.

At our previous meeting, we communicated an interest rate path which entailed that the policy rate would likely be cut at this meeting, if the inflation outlook remained favourable. Since then, inflation has been in line with the forecast we made in June. In the coming months, energy prices will probably bring down CPIF inflation temporarily, which makes it reasonable to focus on inflation excluding energy to assess future inflationary pressures. We can also see that price changes in the shorter run are close to our target (see Figure 6 in the draft Update) and other indicators, such as inflation expectations and company pricing plans, also imply that inflation will be in line with the target.

As has been said, the assessment remains that the Swedish economy is in a mild recession, and growth during the second quarter of this year was somewhat weaker than in the June forecast. Although unemployment during the second quarter was somewhat lower than expected, indicators point to continued fairly weak developments in the near term. The overall outlook for inflation and economic activity clearly indicates, in my opinion, that we should cut the policy rate at today's meeting.

I also share the assessment expressed in the draft Update, namely that it is appropriate to continue with gradual cuts in the policy rate during the autumn – and that this can be done at a somewhat faster pace than we envisaged in June. At that meeting I said that the monetary policy deliberations essentially concern easing monetary policy without risking an excessive increase in demand and causing inflation to rise again. An important question has been how the economy, and not least households, react to the interest rate being cut and real wages once again increasing (see Figure 7 in the draft Update). Even if households continue to have a more optimistic view of the future, the hard data instead implies that their actual consumption remains cautious. We can probably expect demand to remain weak in the household sector going forward, which should contribute to holding back companies' price increases. There are also signs of low inflationary pressures going forward: Wage increases are expected to be moderate, at the same time as pricing plans indicates a normalised pricing behaviour, according to the surveys. Moreover, inflation expectations are anchored around the target at both the short term and slightly longer term (see Figure 9 in the draft Update). This means that the risk of inflation being too high going forward should have declined. All in all, I think there are good arguments in favour of cutting the policy rate at a somewhat faster pace than we assessed in June. However, monetary policy should still be characterised by a gradual adjustment in a less contractionary direction. This creates predictability and gives us the opportunity to manage a different development in the economy than expected, if necessary.

And this brings me to the risk outlook in our assessment. Unfortunately, we are living in a still troubled world, and a number of risks remain both for inflation and the real economy going forward. The geopolitical risks linked to both the war in Ukraine and the conflict in the Middle East have sadly shown no signs of declining over the summer. On the other hand, we have not seen a substantial impact on, for instance, oil prices, which have instead fallen slightly since June. There is quite simply considerable uncertainty, which we will have to manage if the situation requires it, rather than leading to adjustments in monetary policy right now. It is difficult to assess the effects of various scenarios in advance.

I would also like to comment on the turmoil we have seen on the financial markets at the start of this month. It was primarily on the global equity markets where we saw large fluctuations, particularly in Japan, as mentioned earlier, but also in many other countries. The fact that there are adjustments in the stock market is at the same time not the same as a sign of a financial crisis or serious consequences for the real economy. As mentioned in the draft Update, the stock market turbulence should not entail any major increase in risk premiums on the credit market in general, or increased financial instability otherwise. But I nevertheless think that it reflects a sensitivity in pricing on the financial markets that has been based on a positive economic scenario or "soft landing" and is now reacting strongly to question marks regarding future growth, not least in the United States. A practical consequence for Swedish monetary policy as shown in the draft Update, is the large changes that have taken place due to pricing of future interest-rate policy around the world (see Figure 2 in the draft Update).

The krona exchange rate is now at around the same level as it was at our June meeting, but somewhat weaker than we had forecast. Although the exchange rate has remained relatively stable during the financial turmoil in the summer, the krona and its impact on prices remain a continued risk for inflation. As I mentioned earlier, there are clear signs that companies' pricing behaviour has normalised, but changes in the cost and demand situation may change this picture.

Allow me to summarise. My overall assessment is that it is a well-balanced decision to further ease monetary policy somewhat at this meeting and thereafter continue to gradually adjust the interest rate. If the inflation outlook still stands, we ought to be able to cut the policy rate 2-3 more times in the autumn. It is unavoidable that inflation varies around the target in the short term. We should adjust monetary policy to try to stabilise *future* inflation around the target. In this way, the inflation-targeting policy can comprise a stable starting point for future wage formation and financial decisions, at the same time as we have a good development of the economy.

First Deputy Governor Anna Breman:

I support the proposal to cut the policy rate from 3.75 to 3.5 per cent. I also support the monetary policy assessments presented in the draft Monetary Policy Update.

Monetary policy has contributed to inflation falling and now being well on the way to stabilising around the target, even in the medium term. At the meeting in June, there was a risk that services prices would remain on a level incompatible with the inflation target. Recent inflation outcomes, combined with forward-looking indicators, suggest that these risks have decreased. The continuing high level of some services prices, such as administrative prices and hotel prices, does not constitute a significant risk of inflation in the future. In addition, producer prices and corporate pricing plans, wage increases and inflation expectations suggest sustainably low and stable inflation. I therefore support the assessment that we can cut the policy rate more this year than earlier forecasts suggest, which is to say a further two to three times.

At today's meeting, I would primarily like to comment on how I see the scope and pace of further rate cuts. First, I would like to comment briefly on the development of the real economy and the turbulence we have seen on the financial markets during the summer.

The Swedish economy has developed slightly worse than expected, with household consumption, above all, continuing to develop weakly. Signals are mixed concerning the labour market: while employment rose strongly in June, redundancy notices are relatively high, as are bankruptcies. It is important that we see an upswing in economic activity during the autumn. The conditions for this are good and the rate cuts will help. Combined with falling inflation and rising real wages, the rate cuts will lead to a clear improvement in household purchasing power this year and next year (see Figure 7 in the draft Update). Low and stable inflation and lower interest rates will also facilitate corporate investment. This will contribute to stronger demand and also to higher growth and a stronger labour market in the coming years.

The risk outlook for the Swedish economy is relatively balanced. However, it will be important to continue to monitor companies' price-setting behaviour and the development of the Swedish krona and its impact on inflation in the period ahead. Nonetheless, the overall picture is that the greatest risks to the Swedish economy and inflation are related to economic activity abroad and the geopolitical situation.

The turbulence on the financial markets over the summer illustrates the uncertainty existing around both global macroeconomic developments and the tense geopolitical situation. Minor deviations in economic data from market expectations can lead to major changes in pricing on financial markets and also in expectations of central banks (see Monetary Policy Update, Figure 2 and page 3). Not least of these, changes in expectations of the Federal Reserve affect Sweden via market rates and the exchange rate, although temporary fluctuations such as those seen this summer have no substantial significance for Sweden's economy and monetary policy.

However, the international situation is characterised by instability, above all with regard to geopolitics. It is important that monetary policy stands prepared to act, and act forcefully, should the prospects for the economy and inflation change significantly. One example of this is the rapid and forceful rise in inflation following the pandemic and Russia's invasion of Ukraine, when we raised the policy rate by 0.5, 0.75 and 1 percentage point in 2022. However, we should not overreact to small forecast deviations or temporary market volatility.

With this as a background, let me comment on my view of further rate cuts going forward. An important discussion is whether we should cut the rate by 0.25 percentage points or in larger steps. Why not cut by 0.5 or 0.75 percentage points now, if we are planning further rate cuts in the coming months? There is extensive academic research discussing the advantages and disadvantages of gradual adjustments to the policy rate, what is known as interest rate smoothing.[1]

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[1] See, for example, the following speech and research reports: Bernanke, Ben (2004), "Gradualism" speech, Federal Reserve Board of Governors, 20 May 2004, Blinder, Alan (2006), "Monetary Policy Today: Sixteen Questions and about Twelve Answers", Working Paper no. 129, Center for Economic Policy Studies,

I think that this is an important discussion and one to which we should return. I have considered a cut of 0.5 percentage points at today's meeting, but I feel confident that a 0.25 percentage points is a well-balanced monetary policy. Let me briefly describe my main arguments in favour of this.

Firstly, in the event of a widespread economic crisis or when the outlook for inflation has changed significantly, it is important to take rapid and substantial action (as in the case of the pandemic and after Russia invaded Ukraine), but we are not in that type of situation now. Both economic developments and inflation have recently developed largely in line with expectations, and we have gradually adjusted monetary policy towards faster cuts when the inflation outlook has improved.

Secondly, unlike the situation in 2022, the Riksbank now has eight monetary policy meetings a year instead of five. This reduces the need to make cuts in larger steps.

Thirdly, at present there are currently several advantages in gradually adjusting monetary policy. It creates predictability for households, companies and market participants. It can help reduce volatility on the financial markets. It reduces the risk of needing to reverse cuts if inflation is higher than expected. Moreover, there is uncertainty over what is considered a normal level for the policy rate in the long run (see Monetary Policy Report March 2024) and a gradual adjustment of monetary policy enables us to steadily approach what can be considered a normal policy rate in an uncertain situation.

Having said this, it is important that we do not allow ourselves to be tied down by earlier communication regarding the interest rate path. If new information clearly changes the inflation outlook, we need to be able to make different decisions than those indicated by the interest rate path, even in the short term. This includes cuts or raises in larger steps than 0.25 percentage points, if the economic outlook changes significantly and inflation risks deviating from the target more persistently.

Let me emphasise here that by inflation below and above the target I do not mean inflation outcomes in which individual months overshoot or undershoot 2 per cent by a few tenths of a percentage point, I mean a lasting trend. The forecast from June, which still largely stands, entails CPIF inflation being around 1.5 per cent for several months during the autumn. I consider this to be fully in line with the inflation target, as long as the inflation outlook is close to two per

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Princeton University, Söderström, Ulf (2002), "Monetary Policy with Uncertain Parameters", Scandinavian Journal of Economics vol. 104, no. 1, pp. 125–145.

cent and inflation expectations are firmly anchored. It is not individual monthly outcomes that determine the direction of monetary policy; instead it is always an assessment of where inflation is heading in the medium term.

Let me summarise. We have made considerable progress in ensuring that Inflation is low and stable also in the medium term. I support the proposal to cut the policy rate and the forecast that the policy rate can be cut a further two or three times before the end of the year. If the outlook for inflation changes, monetary policy will be adjusted.

Deputy Governor Anna Seim:

I support the proposal to cut the policy rate to 3.5 per cent and the considerations discussed in the draft Monetary Policy Update. I therefore share in the assessment that the policy rate can be cut another two or three times this year.

As I emphasised at the monetary policy meeting in June, policy rate decisions should be based on the expected development of inflation and on how we expect real economic activity to evolve in the long term. We present no new forecasts at this meeting but, according to the June forecasts, inflation will be close to target in both the short and long terms. In addition, since the last meeting, two inflation outcomes have strengthened the view that inflation has now stabilised around the target level while the risks of surprisingly high inflation have decreased. At the same time, we are observing weak economic activity characterised by continued high unemployment, redundancy notices slightly above the historical median and weak growth prospects.

It is therefore clear that monetary policy should be moving towards a more neutral stance. At the June meeting, we argued that monetary policy easing should be gradual. Several arguments for this can be found in academic literature. Allow me to comment briefly on this.

In light of today's decision, one natural question is: if our forecasts suggest that the policy rate can be cut two or three times more this year after today's cut, why not cut the rate by 0.75 or 1 percentage points today? There are several reasons why I consider this inappropriate.

The main reason is that economic developments are uncertain. If future outcomes were to deviate from our forecasts, we would then have to raise the policy rate at a later stage, creating an erratic monetary policy that could give rise to instability and complicate forward-looking decisions on matters such as saving and investment. This uncertainty exacerbated by our being a small, open economy that is strongly dependent on other countries: global events and other countries' economic policies affect the Swedish krona and thereby Swedish inflation.

Additionally, there is uncertainty over the strength and efficiency of the monetary policy transmission mechanism. We do not know with certainty how rapidly and efficiently monetary policy affects inflation and employment, which makes the case for a more tentative approach. Major changes can come as a surprise and give rise to instability and changes in behaviour. An unexpectedly large cut would suddenly free up a large amount of purchasing power, which could create inflationary impulses in an economy in which pricing behaviour may still deviate from the normal and where we cannot rule out the existence of pent-up demand after two years of high inflation and high interest rates.

As Anna Breman noted, there are situations in which large adjustments to the policy rate would be appropriate. In a situation where inflation is rising markedly, if forecast errors are so large that it is obvious that the monetary policy stance is completely wrong or if inflation suddenly rises broadly in other countries, the policy rate should be raised vigorously. This reasoning also applies symmetrically, in that if we see signs that inflation is persistently becoming so low as to threaten confidence in the inflation target or if real economic developments deteriorate rapidly, the policy rate should be cut more forcefully. However, even if we are in a downturn, I see no signs of such a situation at present. This suggests that we should instead be steering the economy, in a cautious and predictable manner, towards a lower interest-rate level.

We will return with new forecasts in September and will continue to work with alternative scenarios in our preparatory process. Even if predictability is desirable, I would therefore like to emphasise that we are constantly prepared to adjust monetary policy if new information suggests that this is justified.

Deputy Governor Per Jansson:

I support the decision to cut the policy rate from 3.75 to 3.5 per cent. I also support the economic assessments, including the assessment that the policy rate can be cut two or three more times this year, if the inflation outlook remains unchanged, as described in the draft Monetary Policy Update.

Since our previous monetary policy meeting in June, inflation has continued to fall. If one excludes the volatile energy prices, inflation was very close to the target in both June and July. When energy prices are included, the outcomes in both of these months were actually slightly below the target, for the first time in three years.

At the same time, several central banks in the world around us have cut their policy rates and the probability of even the Federal Reserve's policy rate beginning to take a downward turn has increased. Although the expectations of how central banks will conduct their monetary policy going forward remain sensitive to fairly small surprises in new data outcomes, the conditions for rate cuts in many countries are generally favourable. Another element is that real economic developments in several places are showing a tendency to weaken, not least with regard to the manufacturing industry and the labour market.

In this environment, the question has been raised as to whether the central banks might not have fallen behind the curve in their policy rate cuts. There have been speculations that to catch up it may be necessary to make double rate cuts, that is, cut the policy rate by 0.5 percentage points rather than the usual 0.25. There have been, and still are, speculations of this nature in both the United States and Sweden.

In the case of Sweden, the speculations may mainly be driven by the adjustment of inflation towards the target appearing to occur faster than in many other countries, with the risk that too low inflation could soon become a problem. Although expectations have subsided a little following the most recent inflation outcome for July, in which CPIF inflation rose and was only a few tenths of a percentage point below the target, I intend to take up a few aspects here that concern this question and are not discussed directly in the draft Update. According to our forecast in the June Monetary Policy Report, which seems to still hold true, relatively negative contribution from energy prices will fairly soon mean that inflation undershoots the target of 2 per cent once again, at the same time as inflation excluding energy prices also appears to end up below target, albeit more short-term and more marginally. Now that the balance of risks for inflation is gradually shifting, from fewer upside risks to more downside ones, there is a high probability that the speculations regarding double cuts will increase again.

To begin with, it is probably important to clarify that our plan for gradual monetary policy easing, which I interpret to entail that we may see it appropriate to “look through” minor deviations from the inflation target and to pause rate cuts, as we did at our previous meeting in June, to await further information and allow uncertainty to dissipate, does not of course rule out the possible necessity of using double rate cuts. The important thing here, in my opinion, is that we conduct monetary policy in a stable and predictable manner, and that there is no loss of confidence in the inflation target, on the upside or downside. The fact that we regularly communicate, for instance, as we are doing at this meeting today, our views on the economic situation and the conditions for monetary policy, including to the extent possible on the policy rate a bit into the future, should reasonably lessen the risk of our actions becoming difficult to predict.

The level of the so-called neutral policy rate, that is, the policy rate compatible with a state of long-term economic equilibrium including inflation at target level, is very important for how quickly one should now attempt to cut interest rates. We are of course reasonably certain that the policy rate is currently some way above this neutral level. However, even if this is the case it does not mean that the monetary policy decisions become trivial and solely involve bringing the interest rate down as quickly as possible to the neutral level. One reason for this is of course that the neutral policy rate is not observable, but must be estimated under considerable uncertainty. Another reason is that it is not only the distance to the neutral rate that determines how inflation, and the economy in general, will develop.

A couple of pertinent examples for the Swedish economy are the coming central wage bargaining rounds, where wage increases could be too high or too low in relation to what is compatible with a balanced economic development, and the stance of fiscal policy, where there is now considerable pressure on politicians to start conducting a substantially expansionary fiscal policy. Another example is that the conditions for monetary policy differ between countries, which can affect the exchange rate, and thus ultimately inflation. We have on repeated occasions seen that expectations of how the Federal Reserve will conduct monetary policy can change a lot and very rapidly, and that this has considerable significance for the development of the krona exchange rate. However, these are just a few examples, more are discussed in the draft Update.[2]

Another aspect that is important in determining the appropriate size of interest rate cuts is the communication of future monetary policy. As longer interest rates are affected by expectations of shorter rates, the difference between, for instance, cutting the policy rate by 0.5 percentage points here and now and cutting it by 0.25 percentage points, but combined with a clear communication of further cuts within the near future, should not be exaggerated. The fact that we are now making the assessment that the policy rate can be cut a little faster than we forecast in June, in addition to cutting the policy rate by 0.25 percentage points, thus also directly contributes to more expansionary monetary policy. Furthermore, we now have more monetary policy meetings every year; eight instead of the earlier five. This means that we can now supplement our policy with further rate cuts more quickly, if such a need should arise.

Let me summarise the conclusions that I draw here for monetary policy. The difference between cutting the policy rate now by 0.5 percentage points, or sticking to 0.25 percentage points combined with communicating a lower policy rate path during the remainder of the year, is not very large. It is difficult to estimate the level of the neutral policy rate, but it is reasonable to assume that

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[2] The fact that there are other factors than the distance between the neutral and the actual policy rate that play a role for inflation (and the economy) is sometimes emphasised by differentiating between the neutral rate in the short term and the long term. Platzer, Tietz and Lindé (2022) call the neutral rate in the long term the "long-run natural rate" and the neutral rate in the short term the "short-run neutral rate", see https://cepr.org/voxeu/columns/natural-versus-neutral-rate-interest-parsing-disagreement-about-future-short-term.

we are above this level, both prior to and after today's decision. However, from this it does not follow that cutting the rate rapidly in large steps is unquestionably the right thing to do. There is no doubt of the direction the interest rate needs to take going forward, but I still think that there are factors supporting a cautious approach. Although the upside risks for inflation have declined, and the probability that the Federal Reserve will also soon begin to cut its policy rate has increased, the uncertainty over the timing of the rate cuts by the Federal Reserve and the ECB is still considerable, and expectations can rapidly change again. This could severely weaken the krona exchange rate in negative scenarios. Fiscal policy is also a factor that I believe speaks in favour of not cutting the rate too quickly. The coming central wage bargaining rounds hold risks of too high or too low wage increases and are therefore a very important factor, albeit one that is difficult to assess at present.

All in all, I still have preferences for gradual adjustment in monetary policy, with changes in the policy rate occurring in small steps combined with the clearest possible communication of future anticipated steps, especially with regard to the near term. This is entirely in line with what is proposed in the draft Update. However, I am fully prepared to reconsider my views if new information supports this, including backing larger interest rate cuts. What is most important to me in this context is that we conduct monetary policy in such a way that deviations from the inflation target are not allowed to be so large and so persistent that confidence in the inflation target could begin to be eroded.

Governor Erik Thedéen:

I support the proposal to cut the policy rate by 0.25 percentage points to 3.5 per cent, and I support the assessments made in the draft Monetary Policy Update. After an initial policy rate cut in May, we are now continuing to ease monetary policy. We are also seeing increased confirmation of our view that the rate of price increase has returned more sustainably to normal levels and that we can thus continue to cut the policy rate at a fairly brisk pace.

At the monetary policy meeting in June, we assessed that it would be possible to cut the policy rate two or three times in the second six months of the year and I myself was inclined to consider that three cuts would be more likely. New information received since then has not changed our view of economic developments in Sweden or abroad in any decisive way. Taken together, data published during the summer indicates slightly weaker growth prospects worldwide. Even if the view of the global economy has not changed decisively in recent months, short-term bond yields in the United States and Europe have fallen, reflecting market participants' changed view of the risk outlook going forward, with an increased risk of a more pronounced downturn with rising unemployment.

The outlook for the Swedish economy that we published in the June report also seems to have been fairly accurate, thus far. While new data indicates slightly weakened growth prospects at home as well, these are only minor adjustments. At the same time, inflation is in line with our target of 2 per cent, it is developing in a relatively stable manner and most forward-looking indicators are favourable. This supports our forecast from June that inflation will remain close to 2 per cent also in the period ahead. Taken together, this suggests a relatively strong likelihood that we will be able to continue to ease monetary policy in the autumn and that we will be able to do this at a slightly faster pace than we forecast in June.

About six months have now passed since we assessed that inflation had improved so much that we could start to discuss cutting the policy rate. The risk that inflation would remain high for a longer period, or even start to rise again, justified our communication that the policy rate would be cut gradually. We also pointed out that the rate of policy rate cuts would be adjusted if new information led to changes in our assessment of the economic outlook and inflation prospects.

Despite considerable uncertainty over economic developments abroad, the risk of high inflation in Sweden has continued to fall since then.

There is, of course, reason to consider carefully whether we have chosen the right strategy for attaining the price stability target while also contributing to a balanced development of production and employment. Quite naturally in the prevailing situation, we in the Executive Board have also discussed whether a policy rate cut of 0.5 percentage points would be justified under the present circumstances. This gives me reason to present my view briefly.

Large policy rate cuts can be needed in certain situations to achieve the desired effect rapidly and avert the risk of a substantial negative outcome. For example, this could be in the event of an unexpectedly large slowdown in economic activity or clear signs of a financial crisis. It would also be justified if there were other reasons for a more substantial revision of the inflation prospects.

In other words, it would require more than just isolated negative economic outcomes or temporary market movements for me to advocate a larger policy rate cut. In the current situation, in which there are many indications that inflation sustainably has come down to a level close to the target and where the Riksbank has a clearly communicated policy for the ongoing, gradual easing of monetary policy, I see no reason for larger individual rate cuts. However, it is important to note that we have increased the pace of rate cuts, even if we have not changed the size of the cuts. The notion of gradual cuts should thus be understood in relation to its context. At the start of the year, when uncertainty was high, this was a matter of small steps over a larger time interval. At present, when inflation prospects seem more certain, we are looking at small steps at every or almost every meeting. In these circumstances, I can also see an advantage in our decision to increase the number of ordinary meetings. With the rate cuts we have now signalled, the policy rate will be 2.75–3 per cent after the meeting in December, which is a major change compared to our forecast, say, one year ago.

Large and surprising policy rate adjustments entail the risk that economic agents will find our actions hard to interpret. In addition, there remains a risk of setbacks if the inflation prospects again deteriorate, thus providing one more reason to proceed gradually. We retain a certain readiness for action but still have a clear direction when setting policy. Another guideline is for the public and market participants to have the clearest possible view of the direction of the policy rate and to understand how and why we make changes. Quite simply, it is important that our reaction function is well understood.

There is also reason to remind people that our rate cuts and the market's expectations of further cuts are already affecting the interest rates faced by households and companies. One example is the banks' mortgage rates, where two-year fixed-rate loans fell by about 0.8 percentage points between last November and July. Of course, many households choose variable rate mortgages but these rates have also already fallen a bit and we have good reason to expect them to continue falling. The point is that our clear signals about the direction of the policy rate, and similar developments in other countries, already have a tangible effect on the interest rates faced by companies and households.

At the start of August, large swings occurred on the financial markets. We saw falling stock prices, rapidly rising volatility in the pricing of various assets and significant drops in medium and long-term market rates. By all accounts, the mechanisms behind this volatility are complex and can be linked partly to shifting expectations concerning the economic developments in the United States and thereby for US monetary policy. In addition, there is a similar uncertainty concerning developments in Japan, including Japanese monetary policy. So far, we have only seen a limited impact on lending and, in itself, stock market turmoil gives no reason to adjust global growth prospects downwards. The turmoil now seems to have subsided for this time but it reminds us that high valuations of financial assets and too much consensus among participants over the outlook make financial markets sensitive to shocks. One commonly used phrase is 'priced for perfection'. This is probably a reasonable way to describe some of the high asset valuations we are seeing. The high equity prices probably reflect a highly optimistic economic outlook among market participants, in which low-growth scenarios are considered unlikely. To this can be added the risks to financial stability that are associated with high volatility. For me, there is no doubt that the heavy turbulence that we saw over a few days at the start of August cannot merely be dismissed as coincidence: it could be a sign of something more fundamental and we need to remain vigilant.

Pricing behaviour among companies remains a risk factor for inflation. Admittedly, companies' responses in the National Institute of Economic Research's Economic Tendency Survey indicate that their pricing plans have been in line with the inflation target of two per cent for some time. However, the experience of rapid price rises in recent years nevertheless leaves me somewhat troubled. There is a risk that many companies now consider it easier to pass cost increases on to consumers, compared to the situation prior to the inflation upturn, and that a considerable number of companies have therefore changed strategy and routines for price setting. If so, this would mean that inflationary pressures in Sweden could change more rapidly than we have assumed in our forecasts. There is a risk that companies will raise their prices quite rapidly even following fairly modest increases in demand, particularly if the companies are experiencing rising costs. We must continue to be on guard here.

At the same time, I would like to point out that I now see inflation risks as quite balanced, compared to the situation last year and earlier this year. For example, it is entirely conceivable that we have not sufficiently considered how rapidly cost pressures have subsided in certain parts of the business sector and the effects this will have on prices. This risk was illustrated in a scenario in the Monetary Policy Report published in June.

All in all, then, both the economic outlook and inflation prospects are overall in line with our forecast from June and I now feel more certain that inflation will stabilise around the target. Conditions are thus favourable for us to be able to continue easing monetary policy over the autumn. We started cutting the policy rate in May and, over the last six months, have been able to gradually lower our assessment of the level of the policy rate at the end of the year. Our forecasts have stood up well and our confidence in sustained, favourable inflation prospects has strengthened. As for myself, I see it as more likely that we will be able to make three – rather than two – full rate cuts so that the policy rate amounts to 2.75 per cent after the December meeting. To sum up: it is now clear that the fog has lifted over the last six months, we feel even more secure about our chosen course and we can therefore continue to somewhat increase the speed.

§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 Riksbank sets the policy rate at 3.5 per cent, which means that it is cut by 0.25 percentage points. The new level of the policy rate shall apply as from Wednesday, 21 August 2024,
- 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 Tuesday, 20 August 2024,
- to publish the minutes from today's meeting at 09:30 on Monday, 26 August 2024.

This paragraph was confirmed immediately.

Minutes taken by

Erik Berggren   Iida Häkkinen Skans

Verified by

Erik Thedéen   Anna Breman   Per Jansson

Aino Bunge   Anna Seim

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