SVERIGES RIKSBANK

Minutes of the Monetary Policy Meeting

December 2024

MONETARY POLICY MINUTES

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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 --- Carolina Backert Charlotta Edler Heidi Elmér Mattias Erlandsson Susanna Grufman Marie Hesselman Ann-Leena Mikiver Olof Sandstedt Åsa Olli Segendorf Jakob Almerud Mikael Apel Charlie Nilsson --- Buster Carlsen (§1–3a) Maria Johansson (§1–3a)

It was noted that Mikael Apel and Charlie Nilsson would prepare the draft monetary policy minutes.

§3 a. Economic developments

Market developments since the last monetary policy meeting

Buster Carlsen, senior market economist at the Markets Department, began by presenting developments in the financial markets since the previous monetary policy meeting in November. Since then, Donald Trump's victory in the US presidential election has been a major theme in the financial markets. Investors are trying to assess the effects of, among other things, tax cuts, deregulations and tariffs on the global economy. A majority of analysts have adjusted their inflation forecasts upwards for the US in the coming year, mostly because they expect a significant increase in tariffs.

At the same time, expectations of rate cuts from the Federal Reserve next year have decreased. This follows a major shift that occurred in the month prior to the election, when the market adjusted its forecasts towards fewer rate cuts in 2025. Despite this, the market still expects the Federal Reserve to announce a policy rate cut of 25 basis points later today. The market now expects the Federal Reserve to cut the rate circa twice more by 25 basis points each time in 2025 according to the pricing of forward rate agreements. The US dollar has continued to appreciate and during the period has traded at its strongest level since 2022. Longer-term US government bond yields rose in early November after the election, but have fluctuated up and down since then. Equivalent European yields fell in November, partly due to weak growth indicators, political uncertainty and the threat of a trade conflict with the United States.

At its meeting in December, the European Central Bank (ECB) decided as expected to cut the policy rate by 25 basis points to provide support for a slowing economy. Forward rates indicate that the market expects the ECB to cut the rate by about 100 basis points in the first half of 2025. Political uncertainty in Europe continues to be a major theme in the fixed-income market with focus on the forthcoming snap elections in Germany and the French government's chances of getting a budget passed by parliament. In December, the yield spread between French and German 10-year government bonds has reached its highest level since the euro crisis in 2012.

US equity indices have reached new record highs in November and December, while the implied volatility on equity markets has decreased significantly since the election result was announced. The broad European equity indices have continued to perform worse than the equivalent indices in the United States.

The Riksbank is expected to cut the policy rate by 25 basis points according to both analysts and market pricing. The major Swedish banks predict that the policy rate will be cut to between 1.75 and 2.25 per cent at some point in the first half of

2025, followed by a longer period without further adjustments. Economic developments are still seen to be in the Riksbank's focus. The krona exchange rate, electricity prices and events abroad are creating uncertainty but are not considered to be an obstacle to the Riksbank cutting the rate in December.

Financial stability – current situation and risks

Olof Sandstedt, Head of the Financial Stability Department, described the situation in the Swedish financial system. The risks in the financial system have decreased in the short term as interest rates have continued to fall. Lower inflation and interest rates make the situation easier for the capital-intensive parts of the economy. However, this comes after a long period of risk build-up and systemic risks remain high. In addition, increased optimism has led to greater risk-taking in the financial markets, which has contributed to the strong performance of both asset and credit markets. At the same time, there is considerable uncertainty abroad and many events have the potential to lead to large movements in financial markets.

The financial situation of real estate companies has improved and these companies continue to issue an increasing number of new bonds, of which Swedish funds have been the largest purchaser. Many of these funds are still vulnerable as unit-holders are offered daily redemptions, while the assets are not sufficiently liquid to meet large withdrawals under stressed conditions, such as during the market turmoil in 2020. The generally short capital commitment periods of real estate companies mean that they may quickly face difficulties in refinancing large bond maturities. Furthermore, the rental market in some real estate segments is weak, which can negatively affect the value of the companies' properties.

The major Swedish banks have ample margins down to the requirements for capital and liquidity. In connection with the Riksbank having reduced the size of its balance sheet, it is clear that foreign investors have returned to the covered bond market. Foreign investors' purchases of covered bonds seem to be largely loan-financed.

During the autumn, some elevated volatility has also been noted in the shortest interest rates in the banks' liquidity management. This is particularly true in periods after the Riksbank's certificate auctions, when the amount of central bank reserves has been smaller than usual. It is important that the banks take their responsibility to maintain the functions of the interbank market.

The current monetary policy drafting process – new data and forecasts

Jakob Almerud, 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 background material for today's decision has been discussed with the Executive Board at meetings on 3, 4 and 6 December. The draft Monetary Policy Report was discussed and tabled at a meeting of the Executive Board on 10 December.

In November, the policy rate was cut by 0.50 percentage points and the assessment was that the rate could also be cut in December, and again in the first half of 2025. Key issues in this drafting process have been how much lower the policy rate needs to be for economic activity to recover and help keep inflation on target going forward, and what the outlook for household consumption looks like. Two other key issues have been how the shift in expectations of policy rates in the United States versus the euro area affects the conditions for Swedish monetary policy, and how a global trade conflict would impact these conditions.

Inflationary pressures are compatible with on-target inflation and inflation expectations are firmly anchored at 2 per cent, especially in the longer term. Forward-looking indicators, such as companies' price plans and producer prices, indicate inflationary pressures that will continue to be compatible with inflation close to 2 per cent also in the future. CPIF inflation was 1.8 per cent in November, which was higher than the Riksbank's previous forecast, but at the same time closer to the inflation target. CPIF inflation excluding the volatile energy prices also remains relatively close to 2 per cent, despite a certain upswing in November.

The Swedish economy is still in a mild recession. GDP increased by 0.3 per cent in the third quarter of 2024 compared with the previous quarter, which was in line with the Riksbank's forecast. Household consumption was almost unchanged during the same quarter, and household savings remained at a high level. At the same time, the demand for exports slowed down. GDP growth in Sweden is expected to be somewhat lower than normal also in the final quarter of this year.

A cyclical divergence has occurred between the United States and the euro area, in which the US economy has performed better than the European economy, although the difference between countries in Europe is considerable. This also affects market participants' view of monetary policy in the two economies going forward. Market participants' expectations of the US policy rate have risen since September, while the expectations of the ECB's future policy rate have fallen somewhat. The Swedish economy is affected more by economic activity in the euro area than in the United States. At the same time, US monetary policy affects global financial conditions to a greater degree than European monetary policy,

and higher rates in the US lead, all else equal, to lower global resource utilisation and lower global inflation. This could be an argument for a slightly more expansionary monetary policy in Sweden but must be weighed against the possibility of a lower policy rate, all else equal, weakening the krona exchange rate and leading to higher inflationary pressures.

In the forecast, the Swedish economy improves in 2025. Increased import tariffs from the United States are not explicitly included in the draft report's economic assessments. This is because of the considerable uncertainty regarding both the size of the tariffs, the goods affected and how other countries might respond. As a result, the uncertainty regarding the effect on the Swedish economy and inflation is also considerable. The question of the effect of tariffs is illustrated in an alternative scenario in the draft report.

Going forward, domestic demand is expected to be the driving force behind the recovery. GDP is expected to grow by just under 2 per cent in 2025 and just over 2.5 per cent in 2026. The forecast for household consumption is largely in line with the forecast in September, and it assumes that consumption will grow more rapidly than GDP in 2025 and 2026. Unemployment is expected to turn downwards again next year, reaching 7.7 per cent by the end of the forecast period. The recovery in the economy will help keep inflation close to 2 per cent going forward.

The proposed forecast in the draft report is based on the proposal for monetary policy described 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 entails cutting the policy rate by 0.25 percentage points to 2.5 per cent at today's meeting. If the outlook for inflation and economic activity remains the same, the policy rate may be cut once again during the first half of 2025. In the forecast, the policy rate then remains unchanged at 2.25 per cent in 2026 and 2027, but there is considerable uncertainty. 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

First Deputy Governor Anna Breman:

I support the proposal to cut the policy rate from 2.75 to 2.50 per cent. I also support the proposed new policy rate path and the monetary policy assessments presented in the draft Monetary Policy Report.

The policy rate has been cut rapidly. Today's decision means that we have made five rate cuts this year, totalling 1.50 percentage points. This gives households

increased purchasing power and companies lower financing costs. It has already had some effect on the interest rates faced by households and companies, but households and companies will increasingly benefit from lower interest rates at the beginning of next year (see Figures 13, 14, 17 and 27 in the draft report).

Monetary policy has a lagged effect. This is both because it takes time for interest rate adjustments to have an impact on the loan stock, and because it takes time for households and companies to adapt their behaviour and, for instance, increase their consumption, invest more money and employ more people.[1] However, stronger purchasing power and higher demand in the Swedish economy are not just an effect of lower interest rates, but also of inflation having fallen and now being in line with the target.

Low and stable inflation is beneficial for all. Now that inflation is lower than the rate of increase in incomes (such as salaries, pensions and study allowances), real wages and real disposable incomes are rising and household purchasing power is strengthening (see Figures 25 and 32 in the draft report). If inflation were to begin to rise again, household purchasing power would be weakened and this would reduce demand and counteract the economic upturn we are now seeing.

Moreover, low and stable inflation is a necessary condition for smoothly functioning wage formation and it facilitates companies' pricing behaviour and strengthens investment. The social partners acted very responsibly when inflation was high.[2] Now inflation is back at the target and inflation expectations are stable. This makes it easier for the social partners to sign wage agreements giving households real wage increases while at the same time preserving companies' competitiveness. In other words, continued low and stable inflation is a necessary condition for favourable economic developments in Sweden in both the short and long term.

The monetary policy considerations at today's meeting therefore concern keeping inflation at a low and stable level and at the same time providing support for an upturn in economic activity in Sweden. We want to cut the policy rate sufficiently to provide support to economic activity in Sweden, but not so much that inflation accelerates. And this needs to be done in an environment where both growth and inflation are substantially affected by global uncertainty.

My assessment is that a cut of 0.25 percentage points at today's meeting and a further cut of 0.25 percentage points at the beginning of 2025 will manage this

[1] The monetary transmission mechanism is complex and works through many different channels (see Chapters 1 and 3 in the draft report for more information about the transmission, and how companies and households are affected, as well as average maturities on deposit and lending rates).

[2] This contributed to a rapid downturn in inflation and to the employment rate in Sweden being one of the highest in the world (see Figure 5 in the draft report).

balancing act. This is a well-balanced monetary policy, given that we know that monetary policy works with a lag and it will therefore take time before the current rate cuts have a full impact.

I have considered a cut of 0.50 percentage points at today's meeting to provide further support to economic activity. But I support a cut of 0.25 percentage points as the positive effects of this year's rapid rate cuts are expected to have a greater impact on economic activity next year. Moreover, inflation excluding energy has risen slightly more than expected. The upturn in core inflation in recent months was also broad – food, goods and services all contributed (see Figures 20, 21 and 22 and Chapter 1 in the draft report for further details).

During 2025, the interest rate path indicates a further cut of 25 basis points at the beginning of the year. The interest rate path reflects the policy rate that is consistent with inflation close to the target with the information we have today. However, it is not a promise that the policy rate will be 2.25 per cent in the long term.[3]

There are many known risks that mean the policy rate may need to be much higher or much lower than the interest rate path shows. Nor do I exclude the possibility of making larger cuts than 0.25 percentage points if the outlook for inflation and economic activity deteriorates significantly. There is particular uncertainty regarding developments abroad, for instance with regard to the geopolitical tensions, lack of clarity regarding trade policy and the government crises arising in Europe.[4] All of this can quickly change the inflation outlook in Sweden. This entails both risks of higher or lower inflation, but all in all I see a somewhat larger risk on the upside, stemming mainly from trade barriers, energy prices, food prices and a weak krona.

At the same time, the risks to economic activity are rather on the downside, which could counteract the upside risks to inflation. Despite increased purchasing power and lower interest expenditure in 2025, households and companies may refrain from consumption and investment if there is considerable uncertainty over the economy. And it is not only global factors that are causing uncertainty. In this context, I would like to highlight the volatility of electricity prices in Sweden as an example. High volatility makes the inflation forecast more difficult and, as in

[3] Moreover, 2.25 per cent is exactly the central point of the interval for the estimated neutral interest rate, and there is a risk that this level will be seen as a signal of a long-term level for the policy rate, despite there being considerable uncertainty at present and the fact that it can only be evaluated retroactively. As the article on the neutral interest rate states: "The uncertainty of these assessments limits their usefulness in practical policy" (see p. 65 in the draft report and Anna Seim's excellent speech "Neutral interest rate - meaning, limitations and assessment").

[4] The risk outlook and several alternative scenarios, including scenarios linked to the risk of a trade war, are aptly described in Chapter 3 of the draft report.

September, we have made estimates of how much energy prices affect inflation.[5] However, they can also affect consumption and investment. If households are worried over large fluctuations in electricity prices, they may be reluctant to increase their consumption, even if higher real wages and interest rate cuts give them greater purchasing power. Companies may refrain from new recruitment and investment, as it is difficult to calculate future electricity costs.

How shall we take into account the risk outlook in the monetary policy decision? The draft report states that we shall "carefully evaluate the need for future interest rate adjustments, in light of the effect of earlier cuts and shifts in the risk profile regarding the outlook for inflation and economic activity." In my opinion, it is important that "evaluate" is not interpreted to mean that monetary policy will become backward-looking, and "evaluate" should not be perceived as "wait-and-see". On the contrary, it means that we adapt monetary policy to knowledge we receive gradually about the impact of the interest rate cuts made, but also to "shifts in the risk profile". What is important is to be prepared to rapidly adapt monetary policy to changed conditions.

Let me summarise. My assessment is that a cut of 0.25 percentage points at today's meeting and a further cut of 0.25 percentage points at the beginning of 2025 is a well-balanced monetary policy to give support to economic activity and at the same time hold inflation in line with the target. Despite an uncertain global outlook, the outlook for inflation and economic activity in Sweden during 2025 is good.

Deputy Governor Anna Seim:

I support the proposal to cut the policy rate by 0.25 percentage points to 2.5 per cent. I also support the policy rate path and the deliberations in the draft Monetary Policy Report.

My decision is based on the descriptions of inflationary pressures and the economic outlook in the draft report. Instead of commenting on the arguments provided there, I would like to describe the challenges we face conceptually, as I believe doing so will contribute to our understanding of a complicated world.

If monetary policy is to be efficient, robust and predictable, it is important that our decisions follow certain principles. One principle that we constantly return to is that we must be *forward-looking*. With today's decision, we have cut the policy rate by 1.5 percentage points since May. Cutting the policy rate stimulates aggregate demand through various transmission mechanisms. Through some of these, the economy is not affected until after 1-2 years, while other mechanisms

[5] See the fact box in the September Monetary Policy Report and p. 49 in the draft report.

are more rapid. In an economy like Sweden, in which a large share of all mortgages are at variable interest rates, we know that the so-called cash flow channel is important.[6] However, even through this speedier channel, the cuts of the last six months have yet to reach their full impact and mortgagors' cash flows will not strengthen more markedly until the spring. This means that, at present, we have only seen the effects of the conducted policy to a limited extent. I am convinced that the rate cuts already made, together with the strengthening of real incomes caused by the lower inflation, will make a tangible contribution to the recovery of the economy in 2025 and onward.

Another important principle is that our forecasts for the policy rate, inflation and various real economic outcomes must be compatible with what we consider a probable *neutral interest rate* in the long term. I am therefore very positive towards us now presenting an updated assessment of the neutral interest rate in the form of an interval. Figure 45 in the draft report illustrates how we can think about the neutral interest rate. The interval of 1.5−3 per cent is our assessment of the interest rate needed to achieve inflation at the target and full employment some years ahead. Our policy rate path should thus level off within this interval, just as the figure shows. However, in this context, one should be aware that (i) the assessment of the neutral interest rate is uncertain and can change over time and (ii) because the economy is continually impacted by shocks that we mitigate with monetary policy, the actual policy rate may deviate significantly from this range. The neutral interest rate is important as an input in our models but, as it is not observable, we must let a broad set of forward-looking indicators form the basis of our decisions and continually analyse incoming data to assess where the economy is heading. My assessment is that we are now conducting a monetary policy that can essentially be considered neutral. I do not believe it will be possible to determine if it is marginally contractionary or expansionary until later when we are actually able to observe which policy rate has closed the inflation and GDP gaps.

Just as at the meetings in September and November, I would also like to comment on how we best can make decisions under the considerable *uncertainty* characterising the world economy at present. At the last monetary policy meeting, the outcome of the US election had yet to be determined and I noted then that exogenous events whose outcomes are hard to predict, such as the election, are not something we can take into account in our decisions. Of course, this is a qualified truth as a number of possible events are always implicitly embedded in our risk assessment. What we can actually quantify and use as input in our models is another matter. To fix ideas, we can theoretically imagine a broad sample space

[6] See, for example, Flodén et al. (2021), "Household Debt and Monetary Policy: Revealing the Cash-Flow Channel", *The Economic Journal*, Volume 131, Issue 636, May, 1742-1771.

in which possible events occur with a given probability. We can then calculate the expected values for the outcomes we care about and potentially act on them. Naturally, in practice, this is significantly more difficult. The effects of several of the outcomes we now envision, such as higher US import tariffs and the consequences of these, are very difficult to estimate. This also applies to the probability that a given measure will be introduced. As we note in the draft report, the direct effects of higher US import tariffs on the Swedish economy will probably be small but, if they give rise to general-equilibrium effects and intensified geopolitical tensions, the consequences may be more far-reaching. Increased trade regulations may also give rise to unpredictable changes of a structural nature, such as reduced globalisation and changes in value chains due to re-shoring. Another difficulty in making decisions under uncertainty is the propensity to react to risks that can actually be measured and modelled. This risks giving rise to a kind of observation bias. Outcomes that may have far-reaching consequences but that we believe are unlikely to occur, known as tail risks, may theoretically weigh heavily in forecast estimates but may practically be very costly to react to in advance. The best we can do in an uncertain world is thus to follow a robust but flexible monetary policy strategy that involves using incoming data for assessment and forward-looking analyses as the picture becomes clearer.

Given the reasoning above and the risk outlook we communicate in the draft report, I currently expect another rate cut in the first half of 2025. But there are signs that inflation may surprise us on the upside. We have already cut the policy rate at a rapid pace and, to the extent that it is possible, we should examine the effects of the policy already implemented on the economy before deciding on our next step. The tentative approach this entails is a challenge precisely because the transmission of monetary policy takes time. However, with the help of forward-looking indicators and systematic analysis, it should be possible to assess where the economy is heading and we are always prepared to adjust monetary policy should the outlook for inflation and economic activity change.

Deputy Governor Aino Bunge:

I support both the proposal to cut the policy rate to 2.5 per cent at this meeting and the forecasts and assessments made in the draft Monetary Policy Report.

We are leaving behind us a year marked not only by ongoing geopolitical tension abroad and low growth in the Swedish economy but also by falling inflation and lower interest rates. Overall, I think that the view from the last meeting in November remains largely unchanged. Inflationary pressures have stabilised in line with the target, which is very positive, but economic activity remains weak.

This is a generalised description and there are, of course, nuances to the picture, so allow me to start with inflation.

As the draft report notes, inflation has become higher than in our previous forecast. As regards CPIF inflation, we are now well into the scenario with increased energy prices that we described in the fact box in the Monetary Policy Report in September and that now exists in updated form on page 49 of the draft report. In this context, it is important to point out that there are both upside and downside risks as regards the development of energy prices and these cannot be 'chased' with a monetary policy that has lagged effects.

At the same time, CPIF inflation excluding energy amounted to 2.4 per cent in November, which was also higher than expected. This deviation is judged to be connected partly with unexpectedly high prices for food and goods, although inflation is also being maintained by rents and administrative prices that are being affected by previous cost increases. Even though inflation in terms of the CPIF excluding energy, along with other underlying measures, is thus slightly above target at present, I share the assessment made in the draft report that this deviation is temporary. Forward-looking indicators such as companies' price plans and long-term inflation expectations remain stable and suggest inflation close to the target going forward. Of course we shall monitor energy prices, tariffs and the effects of a weak krona on inflation but, so far, I think that the risks are balanced.

One important precondition for inflation to stay around the target in the future is that the economic recovery we forecast materialises. As regards the development of the economy internationally, this is characterised by increased divergence as growth in the United States pulls ahead of Europe. However, US growth is very much driven by fiscal policy stimulation measures, which are certainly strengthening demand now but also pose a risk to the economy in the longer term. At the same time, the policy expected from the new administration includes increased tariffs and reduced immigration that will instead act in the other direction and restrain growth. However, when we weigh together countries according to their significance for Sweden's foreign trade, Europe still has a dominant position. And in Europe, there are no strong markets to meet Swedish exports. In addition, uncertainty over the outlook is increasing due to the government crises arising in France and Germany.

In Sweden, we have struggled over the autumn with economic activity not having picked up as we had hoped. Now, however, we are starting to see signs that consumption may be on the way to turn upwards, both in 'hard data', in the form of increased turnover in the retail trade, and in 'soft data', in the form of household confidence in the National Institute of Economic Research's Economic Tendency Survey now being above its historic average. Turnover has also increased on the housing market, which could indicate that households' view of their finances is stronger than before.

The increased turnover will also gradually contribute to increased housing investment and perhaps also to increased housing-related consumption such as furniture, furnishings and white goods. Households will feel that they have significantly more money in their wallets next year (see Figure 32 in the draft report). I also think it is interesting that saving seems to have stabilised and households perhaps now have the buffers they desire (see Figure 17). One concern is that households are still being affected by the earlier rapid price rises. Their perceived purchasing power is probably lower than the development of real wages would indicate. In addition, rents are still in a rising phase, even though mortgages are becoming cheaper.

Overall, domestic economic activity is close to the turning point but needs more support from monetary policy − and that support is needed now. At the last meeting in November, I emphasised that the larger cut we were then making was a matter of making monetary policy easing somewhat more ‘front-loaded’.

In essence, I stand by this assessment. And, in line with this, I can imagine that the policy rate will probably be cut again when we meet after the festive season. However, as we note in the draft report, it is also important to consider the delay existing between rate cuts and their effects on the economy. Transmission is probably considerably faster in Sweden than in many other countries due to the high interest-rate sensitivity of households. Now we have made quite heavy cuts over a short period (see Figure 9 in the draft report). Those cuts are starting to make an impact – and this is also expected to grow in force over the spring. In light of this, I consider it reasonable to take a more tentative approach in the monetary policy strategy, as described in the draft report.

At the same time, our alternative scenarios are a tool to help us reflect on why our forecasts could be wrong and how we should react in such a case. This time, the forecast includes no assumptions on the effects of future tariffs and trade barriers, quite simply because there is not enough information on how these would be formulated. However, one of the alternative scenarios in the draft report addresses the effects of the introduction of trade barriers after the US election, in combination with increased geopolitical turmoil. One thing the scenario makes clear is that, even if tariffs as such do not have a particularly great impact, that impact may be significantly greater if it is followed by a more widespread trade war and increased geopolitical tension. There would really be few winners in such a situation but this does not mean that we do not need to consider that it may happen.

In our other alternative scenario this time, we point out the risk that economic activity will not pick up speed as expected and that further stimulation may then be needed. As the draft report notes, there are both domestic risks and international risks that could cause such a development. I continue to be

concerned about this. It really cannot be ruled out that further policy rate cuts may be needed.

Let me conclude by saying that I am fundamentally positive about developments: Here, at the end of 2024, I think it is worth reflecting over how much has happened in the Swedish economy in recent years. In advance, few people could have imagined that inflation would reach 10 per cent, as it did at the end of 2022. But now it has been close to the target for a while. Economic activity is also showing signs of picking up. There is every reason to look forward to 2025 with confidence!

Deputy Governor Per Jansson:

Since our last monetary policy meeting in November, there have been a few, not entirely unimportant, shifts in the conditions for monetary policy. Today, I would therefore like to focus my comments on exactly this issue and the significance I currently perceive these changed conditions to have for our interest rate decisions going forward, including of course the decision at today's meeting.

I will begin with the inflation situation. The substantial decrease in the risks of too high inflation has been a recurrent theme in my comments at more or less all our monetary policy meetings this year. In June, when we left the policy rate unchanged at 3.75 per cent, I did express some concern that the decline in inflation was too slow and companies' pricing behaviour had not fully returned to normal. Since then, however, I have felt increasingly convinced that we actually, at least this time round, have won the battle against inflation, and at our last meeting in November, I even noted that the downside risks had started to dominate, due largely to the weak demand development in the Swedish economy.

However, the two new inflation outcomes since our November meeting, for October and November, mean that my optimistic view of the inflation picture has taken a hit and shifted somewhat in a more negative direction. Our forecasts from the Monetary Policy Report in September implied relatively large underestimates of the development of inflation both including and excluding energy prices. The forecast error was particularly large for inflation including energy prices in November, almost one whole percentage point.

Even excluding energy prices, however, our underestimate was quite significant, just under 0.3 percentage points in October and a bit over 0.4 percentage points in November. The forecast error for inflation stripped of energy prices for both months is largely related to unexpectedly sizeable inflation contributions from goods and food prices, each of which explains about half of the underestimate. It cannot be ruled out that the weak development in the krona exchange rate is a

factor behind the surprisingly large contribution to inflation from both goods prices and food prices.

As I have pointed out many times before, it is not temporary inflation effects from unexpected fluctuations in energy prices that worry me in this situation. All central banks agree that there is no point using monetary policy to try to counteract large and rapid changes in energy prices, as long as they do not affect confidence in the inflation target. In monetary policy, one should consequently 'look through' such fluctuations.

The Riksbank's forecast in September was that negative energy price contributions would cause CPIF inflation to be temporarily, for about a year, below the inflation target. While developments since then imply that energy prices have risen much faster than expected, they also underline that the assessment that the large negative energy price contributions would be temporary was entirely reasonable and correct. And the fact that CPIF inflation is now significantly closer to the target than expected, 1.8 per cent instead of 0.9 per cent, is hardly something we need to feel gloomy about. That said, it should of course be borne in mind that energy prices also going forward can surprise on both the upside and the downside.[7] But if this happens, hopefully there will now at least be no ambiguity about which principles are decisive for whether or not this has a bearing on monetary policy.

Instead, what has given me a slightly more pessimistic view of the inflation picture has a lot to do with the underestimates of inflation excluding energy prices that have characterised our forecasts over the past two months. In addition, it is not just the development of inflation excluding energy prices that looks slightly worrying but this also applies to the majority of our measures of underlying inflation. The median of the measures of underlying inflation that we regularly update amounts to 2.6 per cent for November.[8] The majority of the measures also exhibit an upward tendency and are slightly above 2 per cent, when analysed for shorter-term price increases, such as one-, three- or six-monthly changes.

As noted in the draft report, certain prices reflecting earlier cost increases, such as rents and administrative prices, are now contributing to pushing up various measures of underlying inflation. Although these price effects can be expected to gradually diminish going forward, the overall picture of more underlying inflation is, in my view, still clearly worse than before. The fact that all this is happening in

[7] As in the Monetary Policy Report in September, a fact box in the draft Monetary Policy Report highlights the sensitivity of CPIF inflation for both higher and lower energy prices.

[8] For more information on the Riksbank's measures of underlying inflation, see https://www.riksbank.se/en-gb/statistics/macro-indicators/underlying-inflation/. The median for November amounts to 2.6 per cent for the five measures presented in Figure 22 in the draft report but also if CPIF inflation excluding energy prices and excluding energy prices and perishables is included.

an international environment where concerns about new inflationary impulses have increased does not help matters, of course. For us in Sweden, it will be very important in the period ahead to continue to carefully analyse the inflationary effects of the weak krona exchange rate and to be vigilant that companies do not start to change their pricing behaviour again in a more aggressive direction. The fact that representatives of food companies show no understanding whatsoever that such a change in behaviour would be problematic does not, of course, make one feel any less worried.[9]

With this, I turn to the second factor where I believe that some rather important shifts in the conditions for monetary policy have taken place, namely the economic situation. The shifts here are not so much about changes in the Swedish economy. Here, as in the past, a number of indicators, such as household and business confidence and housing market activity, continue to point to an imminent recovery. But in so-called hard data, such as the GDP indicator, the LFS statistics for the labour market and Statistics Sweden's monthly indicator for household consumption, there are as yet no concrete signs of improvement. While retail sales are increasing somewhat, this is unfortunately one of the few bright spots in the hard data.

The shift I have in mind is instead about the situation abroad. In the United States, there is considerable uncertainty about the design of economic policy going forward, including whether new import tariffs will be imposed on Europe and other countries and, if so, how large they will be. In Germany and France, an already rather difficult economic situation has been aggravated by government and budgetary crises. This is reflected not least in the continued weakness of business confidence indicators, particularly in manufacturing. This has contributed to a deterioration in the euro area's growth prospects next year. Geopolitical risks also show no signs of abating. Here, the development is rather in the wrong direction and could be further exacerbated by a global trade conflict. All in all, the outlook for the international economy has thus become even more uncertain and for our closest neighbours has also deteriorated. Of course, these are not shifts that will facilitate an economic recovery in Sweden.

Despite these fairly widespread problems in the world economy, I feel fundamentally optimistic that the Swedish economy will actually improve in the first half of next year. Real incomes have already increased significantly as inflation has fallen. Next year, there will be a significant strengthening of household cash flows as the Riksbank's interest rate cuts have an increasing impact on household interest payments and fiscal policy also contributes with tax relief, among other things. At the same time, the situation for companies will also

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[9] See https://www.svd.se/a/eM6dnM/livsmedelsforetagen-absurda-utsagor-fran-riksbanken. Newspaper article in Swedish only.

clearly improve. There are also signs that households are no longer increasing their saving. This to a greater extent creates the circumstances for future income increases to be spent on consumption.

Let me summarise the conclusions I draw for monetary policy from these rather complex shifts in the inflation and economic situation. The overall inflation picture has deteriorated somewhat. Underlying inflation has risen unexpectedly and it is not clear that this development is driven by effects that will wear off rapidly. The international environment appears to be becoming more inflationary, but at the same time there is considerable uncertainty about future global economic developments and growth prospects for our closest neighbours have deteriorated in the short term.

Nevertheless, I am optimistic that the Swedish economy will improve in the first half of 2025. But this improvement is not yet reflected in any hard data and this, together with the international economic challenges and my assessment that the deterioration in the inflation picture is not too great anyway, means that I think that the policy rate should nevertheless be cut from 2.75 to 2.5 per cent. Another argument for cutting the rate today is that 2.75 per cent is in the upper region of our new interval for the long-term neutral interest rate. This means that the risk is quite small of the policy rate being too low already after the cut at today's meeting.

For basically the same reasons, I also assess that it should be possible to make a further cut to the policy rate in the first half of next year. But I believe this cut needs to come quite early in the year, in January or possibly at the meeting after that in March. If our forecasts are accurate, the economy should already start to strengthen quite significantly during the first quarter of next year at the same time as inflation excluding energy prices continues to be around half a percentage point above the inflation target. In such a situation, it may be perceived as less suitable to cut the policy rate still further. But these are my thoughts on monetary policy today and the great uncertainty that now prevails means that we need to be open to rethinking in all directions, to have a "tentative approach" as the draft report aptly puts it.

With this, I support the forecasts and the monetary policy assumptions in the draft report.

Governor Erik Thedéen:

I support the proposal to cut the policy rate today by 0.25 percentage points to 2.5 per cent, and I support the assessments made in the draft Monetary Policy Report. The outlook for inflation is in line with the target and the long-term inflation expectations are firmly anchored at 2 per cent. Some consumer prices

have, however, become higher in recent months, compared with our forecast in September. This is not least the case for food and goods prices, which contributed to the rate of price increase excluding energy rising to 2.4 per cent in November. Some of the factors contributing to the upturn are assessed as temporary, however. In time, we are expecting the rate of increase in rents and administrative prices, which is currently unusually high, to fall. An overall assessment shows that most indicators, including companies' pricing plans in the Economic Tendency Survey, point to an inflation rate in line with the target. But there are reasons for some caution now that inflation outcomes excluding energy have been somewhat higher than our forecasts.

In August and September, electricity prices were unusually low, which contributed to CPIF inflation temporarily falling some way below 2 per cent. Our assessment then was that the situation was transitory and that it should not affect the monetary policy considerations. Higher energy prices then contributed to CPIF inflation rising to 1.8 per cent in November. Temporary, unexpected fluctuations in energy prices are probably something we will have to live with going forward, and monetary policy neither can nor should try to parry them. If CPIF inflation is to stabilise close to the target of 2 per cent in the medium term, it is therefore often wise to look past these fluctuations.

When it comes to economic developments in general, GDP has been weak for a couple of years and unemployment has risen, but we and other forecasting institutions now see a recovery ahead. It is true that various economic indicators are currently to some extent sending contradictory signals; for instance, GDP fell in October according to Statistics Sweden's preliminary compilation, and the labour market continued to weaken in November. However, households' expectations of the economy are optimistic and the same applies to expectations among companies in the durable goods segment. In October, sales of furniture and other household-related equipment rose, and there may be a link here to developments in the housing market, where both turnover and prices have picked up.

I welcome the fact that the turnover in the housing market has risen and appears to be normalising. The reason for the increased number of sales is probably partly due to a pent-up need to move, which is now increasingly being met. However, this development is also more generally a signal of a more positive economic outlook among households. Historical data contain a clear covariation between developments in the housing market and sales of certain types of durable goods, such as furniture.

During the coming months, many Swedish households will benefit from rising real wages, falling mortgage rates and the fiscal stimulus measures that have been decided. Lower interest rates and an upturn in consumption will also strengthen

companies’ revenue and stimulate investment. The conditions for higher growth and rising employment are thus favourable. Moreover, statistics show that households have a relatively high level of saving, which also creates scope for increased consumption. Higher economic activity is, of course, desirable in itself and going forward it also contributes to stabilising inflation at the target of 2 per cent.

Today's interest rate decision means that the policy rate has been cut by 1.5 percentage points this year. After such a significant change in monetary policy, it is natural to ask oneself: how much lower might the policy rate need to be cut for the support to economic activity to be sufficient?

The simple, short answer is that it is too early to be certain. To explain my view on this question, I would firstly like to take a brief look back at the decisions we have taken so far this year. At the start of the year, when the policy rate was 4 per cent, it was clear that monetary policy was having a contractionary effect on economic activity; economic activity slowed down and inflation fell. Inflation then continued to fall during the first few months of the year, and we therefore assessed in May that it was appropriate to begin cutting the rate, albeit at a relatively slow pace. When, later on, we became more confident that the rate of price increase was really falling towards the inflation target, we were able to increase the pace of the cuts.

Now that the rate has been cut by 1.5 percentage points, it is probable that monetary policy will no longer have a contractionary effect, once the cuts have attained their full effect. One factor that makes the assessment considerably more difficult is that it takes quite a long time before changes in the policy rate have full impact. This applies, for instance, to the interest rates that households pay on their mortgages. A significant part of our policy rate cuts has taken place during the third and fourth quarters, which means that although the average interest rate on outstanding mortgages has begun to fall this year, as a result of the fixed periods for interest rates, much of the fall in households’ interest payments will not occur until 2025. That monetary policy works with a lag is also confirmed by recent empirical estimates of monetary policy transmission in Sweden, which were discussed in the September Monetary Policy Report. The estimates indicate that it takes around 2 years before a change in the policy rate attains maximum impact on economic activity. The cuts we have already decided on will thus, according to these results, have a positive effect on GDP growth up to the end of 2026.

Moreover, there is reason to believe that the coming fiscal policy stimulus will affect the economy with some time lag. Changes in various tax rates can be difficult to review and to translate into direct effects on one's own personal finances. But once the changes have an impact on households’ cash flows, they

should, together with the delayed effect of lower interest rates, have a positive effect on household consumption in 2025.

My conclusion is that it will soon be appropriate to wait and see before making any further changes to the policy rate. Quite simply, we will need to adopt a tentative approach and have patience, so that the cuts we have already made have time to make their mark on indicators and other data, before we consider new measures. Our current assessment, which is reflected in the interest rate path, is that it is probably appropriate to cut the policy rate one more time during the first half of 2025. But a tentative approach also includes carefully evaluating the effects of cuts already implemented and being prepared to act if the overall risk outlook, on the upside or downside, were to change significantly. Using a tentative approach is thus not the same as being passive.

The draft report on the table today contains an article on the long-term neutral interest rate, and I would like to take the opportunity here to comment on the conclusions of this analysis. Estimates of the long-term neutral interest rate provide guidance in the question of what is a reasonable forecast for the policy rate in the long term, when the economy is in balance and neither needs tightening nor stimulus. The estimates are uncertain and we therefore present an assessment in the form of an interval, which extends from 1.5 to 3 per cent. But it is important to remember that there are several sources of uncertainty regarding the longer term level of the policy rate, in addition to those reflected in the interval. The economy is constantly buffeted by various types of cyclical shocks, affecting what is considered an appropriate level for the actual policy rate. These shocks add to the total uncertainty regarding future interest rates, which on the whole is considerable.

It is also important to remember that estimates of the long-term neutral interest rate cannot be used as a starting point for determining how tight or expansionary monetary policy is *now*. At present, we assess that a policy rate of just over 2 per cent is probably a suitable level for stabilising resource utilisation and inflation. In this sense there is currently a temporary correspondence with the mid-point of the interval for the long-term neutral interest rate. But there is no reason to expect this correspondence to persist. As I said, we will carefully evaluate the effect of the cuts made and the need for future rate adjustments as new information becomes available.

This tentative approach can be wise for other reasons, too. International developments are still uncertain, with considerable risks linked to geopolitical and trade conflicts, and to uncertainty over the economic prospects in the world's largest economies. One expression of this uncertainty is the current, intensive discussion among economists and policy makers about the increasing gap between growth prospects for the United States and the euro area, and the

uncertainty this creates regarding future interest and exchange rates. With regard to Swedish monetary policy, it is specifically the weak krona exchange rate, and the uncertainty regarding its impact on inflation that constitute further sources of risk.

These different risk factors could trigger inflationary impulses to which monetary policy may need to react. We have recently seen unexpectedly large price increases on food, both on the world market and in Swedish shops, and this gives cause for heightened vigilance. At the same time, there is a possibility that the international factors will contribute to weaker economic developments that could justify further monetary policy easing.

To summarise, there are thus several reasons for now shifting to a more tentative approach when setting monetary policy. We need to evaluate and analyse how the Swedish economy responds to the rate cuts we have made, how the fiscal stimulus affects economic activity and how international economic conditions develop. It is reasonable to assume the conditions are right for a fairly strong recovery from 2025 and onwards, with good growth, falling unemployment and low, stable inflation. At the same time, the Swedish economy is well-equipped to withstand potential shocks; public finances are strong and the framework for price-setting and wage formation is functioning smoothly. We have considerable monetary policy freedom to act in the way required to contribute to such a desirable development. The tentative approach does not at all exclude an active interest rate policy if this is needed. The fog has mostly lifted to enable us to see the road ahead, and we have picked up speed. It is now a question of assessing whether the speed is sufficient, or whether it needs to be increased further, or whether it is too fast. This evaluation requires some patience.

§4. Monetary policy decisions

The Executive Board decided

- in accordance with Annex A to the minutes Policy rate decision (including the enclosure Monetary Policy Report).

This paragraph was confirmed immediately.

Minutes taken by

Mikael Apel Charlie Nilsson

Verified by

Erik Thedéen Anna Breman Per Jansson

Aino Bunge Anna Seim

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