International Commentary — August 20, 2024

Riksbank Cuts Rates, Hints At Faster Easing Ahead

Summary

- Sweden's central bank—the Riksbank—lowered its policy rate 25 bps to 3.50% at today's monetary policy announcement, its second rate cut this year. The accompanying commentary was dovish in tone, with policymakers citing a continued deceleration in inflation and weak economic growth as the driving factors behind the decision. Policymakers signaled that "the policy rate can be cut somewhat faster than was assessed in June", and that rates may be cut two or three more times this year.
- A broad range of economic data, in our view, supports the Riksbank's more dovish announcement. GDP looks to have declined in Q2 and household consumption has been weak, and sentiment surveys are consistent with only modestly positive growth moving forward. Wage growth has started to slow, and inflation has already returned close to target.
- As a result, we expect the Riksbank will ultimately deliver on the signal of faster easing from today's announcement. We expect 25 bps rate cuts at the September, November and December announcements, which would see the policy rate end 2024 at 2.75% (compared to our previous forecast of 3.00%). As the policy rate moves closer to a neutral level we forecast a more gradual 25 bps per quarter pace in 2025, with rate cuts forecast in March, June and September next year, which would bring the policy rate to a low of 2.00%.

Economist(s)

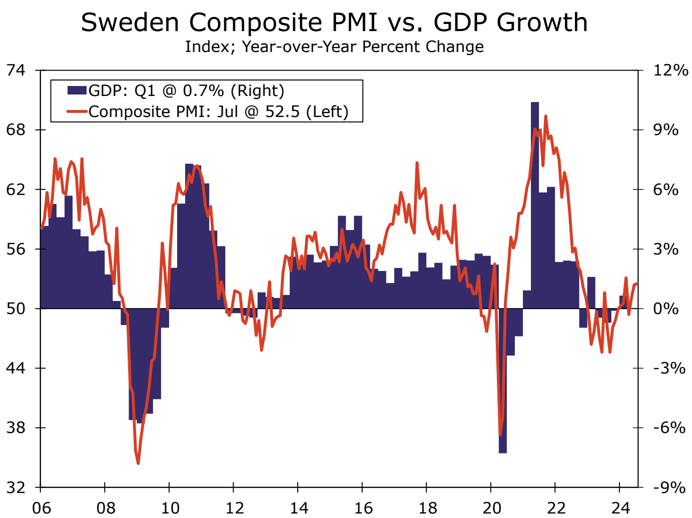
Nick Bennenbroek
International Economist | Wells Fargo Economics
Nicholas.Bennenbroek@wellsfargo.com | 212-214-5636

Anna Stein
Economic Analyst | Wells Fargo Economics
Anna.H.Stein@wellsfargo.com | 212-214-1063

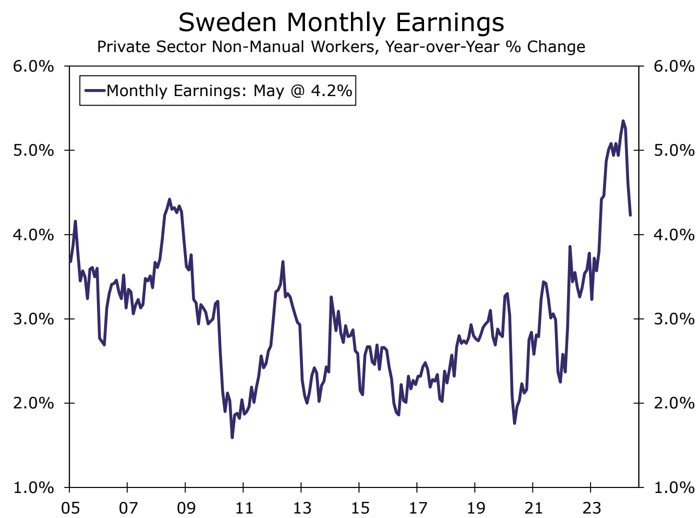
Riksbank Cuts Rates, Hints At Faster Easing Ahead

Riksbank policymakers lowered the policy rate by 25 bps for the second time this year to 3.50%, in line with consensus expectations, and offered dovish commentary in the accompanying monetary policy announcement. Officials highlighted a continued deceleration in inflation and weak economic growth as the driving factors behind their decision to restart the easing cycle. Policymakers appear to be reasonably confident that inflation can sustainably return to the 2% target, due to developments in CPIF inflation, long-term inflation expectations, and other indicators such as producer prices and company pricing plans. Officials point to a moderation in wage growth as another supportive factor for inflation returning to target. The central bank's monetary policy update also highlighted recent softness in economic growth, noting a weaker-than-expected GDP growth outcome in Q2-2024 and characterized the country as in a mild recession, with household consumption and housing investment driving the weakness. Labor market developments were described as "subdued".

The Riksbank's forward guidance in this announcement was more dovish than previously. Policymakers signaled that "the policy rate can be cut somewhat faster than was assessed in June", at their last meeting, and that if the inflation outlook continues to be consistent with CPIF inflation sustainably returning to target, "the policy rate can be cut two or three more times this year." This introduces the possibility of one more policy rate cut in 2024 relative to what officials signaled in their June statement. Finally, policymakers touched on risks to the outlook. They called out geopolitics, local and global economic activity developments, and the krona exchange rate as uncertainties in the outlook that could affect their future conduct of monetary policy. While it is possible that some of these risks could result in upward price pressures, we still view this decision and statement as clearly dovish as policymakers appear to be focused on the slower inflation and softer economic growth data seen as of late.



Source: Bloomberg Finance L.P. and Wells Fargo Economics

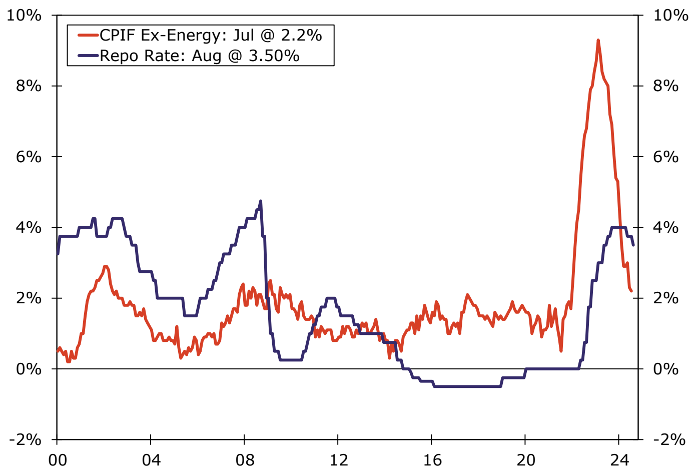


Source: Bloomberg Finance L.P. and Wells Fargo Economics

The Riksbank's dovish monetary policy announcement is understandable considering this year's economic trends of underwhelming growth and progress on bringing inflation closer to target. While GDP rose 0.7% quarter-over-quarter in Q1-2024, that comes after a year of essentially no growth during 2023. There are also indications that at least some of that Q1 GDP gain was given back in the second quarter, as the Q2 GDP indicator fell 0.8% quarter-over-quarter. Swedish household consumption has also been very weak during the first half of this year, showing a monthly decline in four out of six months, to be down 1.4% year-over-year in June. Looking ahead, Sweden's sentiment surveys are mixed, with the manufacturing PMI falling in recent months to 49.8 in July, while the services PMI has risen in recent months to 53.8 in July. The composite or economy-wide PMI has also improved, though at 52.5 in July it is consistent with only a modestly positive pace of GDP growth. Given these developments, we are comfortable with our moderate GDP growth forecasts of 1.1% for 2024 and 1.7% for 2025.

Given these subdued growth trends, the unemployment rate has risen to above 8% in 2024 from a low of below 7% in 2022. And as labor market conditions have eased, wage growth has also slowed, as monthly earnings of private sector non-manual workers slowed to 4.2% year-over-year in May. This is consistent with the Riksbank's economic projections from its June announcement, which anticipated a slower pace of wage growth from the second quarter. That in turn supports the central bank's increasing confidence that inflation can be sustained close to target. **As a result, we expect the Riksbank will ultimately deliver on the signal of faster easing from today's announcement. We expect 25 bps rate cuts at the September, November and December announcement, which would see the policy rate end 2024 at 2.75%** (compared to our previous forecast of 3.00%). As the policy rate moves closer to a neutral level we forecast a more gradual 25 bps per quarter pace in 2025, with **rate cuts forecast in March, June and September next year, which would bring the policy rate to a low of 2.00%.** While recent developments make us comfortable in calling for a faster pace of easing as our base case, we do think the risks are perhaps still tilted to a more gradual pace of rate cuts, especially if the European Central Bank were to prove unexpectedly cautious in lowering interest rates, or if the Swedish krona were to display excessive weakness.

Swedish Policy Rate vs. CPIF Ex-Energy Inflation



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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey George	Economic Analyst	704-410-2911	Aubrey.B.George@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Ali Hajibeigi	Economic Analyst	212-214-8253	Ali.Hajibeigi@wellsfargo.com
Coren Miller	Administrative Assistant	704-410-6010	Coren.Miller@wellsfargo.com

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