

Fast Comment Sweden

Upside surprise again, and it does not stop here; July CPI preview

- Widening gap between inflation outcomes and Riksbank's forecast
- Wages add to already broad range of inflation drivers
- Should trigger more policy tightening from the Riksbank

Widening gap between inflation outcomes and the Riksbank's forecast

We expect a July CPI report showing headline CPIF inflation easing to 8.2 percent, y-o-y, from 8.5 in June. The step down follows from some altitude drop in the still very elevated energy prices. CPIF excluding energy (CPIFXE), on the other hand, keeps picking up and we forecast that it reached 6.5 percent in July. For both measures, our forecast implies that the Riksbank's forecast error will widen further. And it does not seem to stop here - at year-end, we see CPIFXE trending more than 1pp above the Riksbank's path, by next summer, the distance will have grown to around 2pp. If our July CPI call proves to be correct on August 12. There is much to suggest that the Riksbank will signal a steeper policy rate rise than so far communicated, starting with a 75bp rise in September.

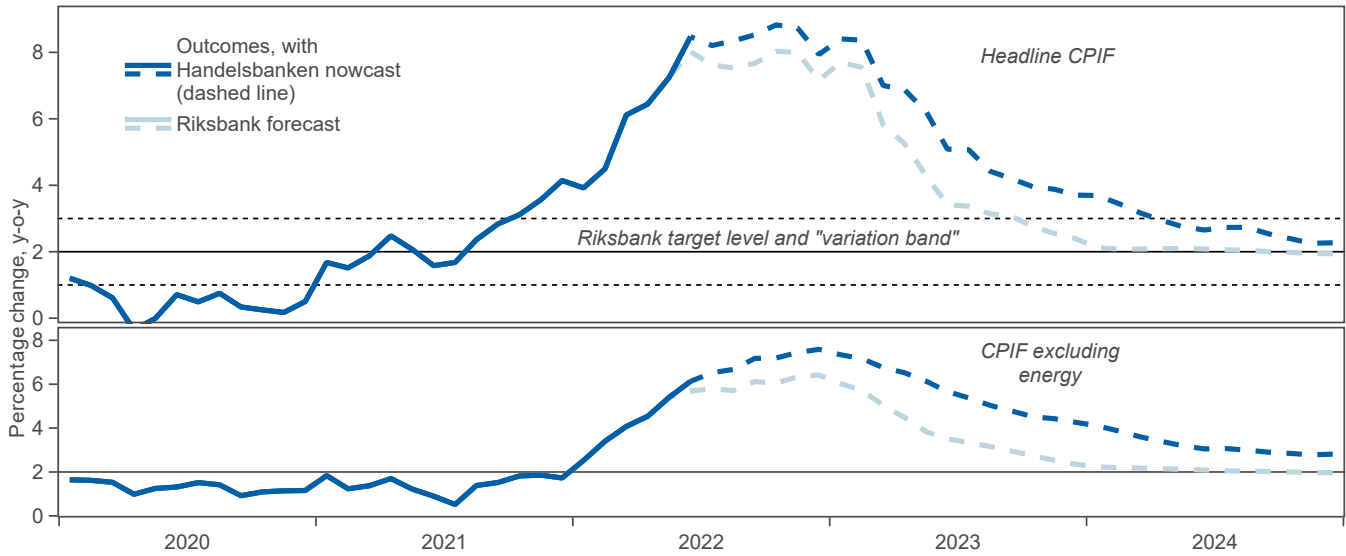
Wages add to already broad range of inflation drivers

The inflation pressure remains relentless, even as manufacturing firms now start to feel waning input price increases, on the back of cooling commodity prices. Instead, other factors, such as wage increases, are driving inflation. Lately, a wage drift trend appears to have begun, with realised wages more firmly surpassing levels stipulated by the central agreements, read more in this [National Mediation Office report](#) (Swedish). Already firms have been citing domestic costs as one of a multitude of reasons behind their price increases (see graphs below), and this could be compounded by this surge in wage increases. Firms' year-ahead inflation expectations have risen tremendously in the last year, even more than other leading indicators for CPIFXE inflation. At the same time, there is an unusual price setting behaviour now, where competitors' price changes are primarily cited as a reason behind price *increases*, not decreases like in normal times. Judging by their own upbeat profitability assessments, firms are, so far, more than successful in passing costs on to consumers and/or preparing for any future cost increases they worry about. The question is how long this stubbornly high inflation lasts, and currently our nowcast says all the way through 2023.

Should trigger more policy tightening from the Riksbank

The surprisingly high inflation, driven by a broad range of factors stemming from both rising inflation expectations, high demand and supply side disruption, should mean that the Riksbank needs to do more to curb inflation. Reaching the longer run neutral policy rate level, which according to recent Riksbank signals could be as low as 2 percent, may not be enough. Whether or not the Riksbank's hikes make the policy rate stop stimulating the economy (or even start restricting it) should be decided by the real rather than the nominal policy rate. That implies the *short run* neutral policy rate is clearly higher than 2 percent, since underlying inflation is expected to be somewhere between 7.5 and 3 percent over the next few years. While that suggests more rate hikes than the Riksbank has signalled, we still worry that the Swedish economy is interest rate sensitive - something that dampens the need for policy rate rises.

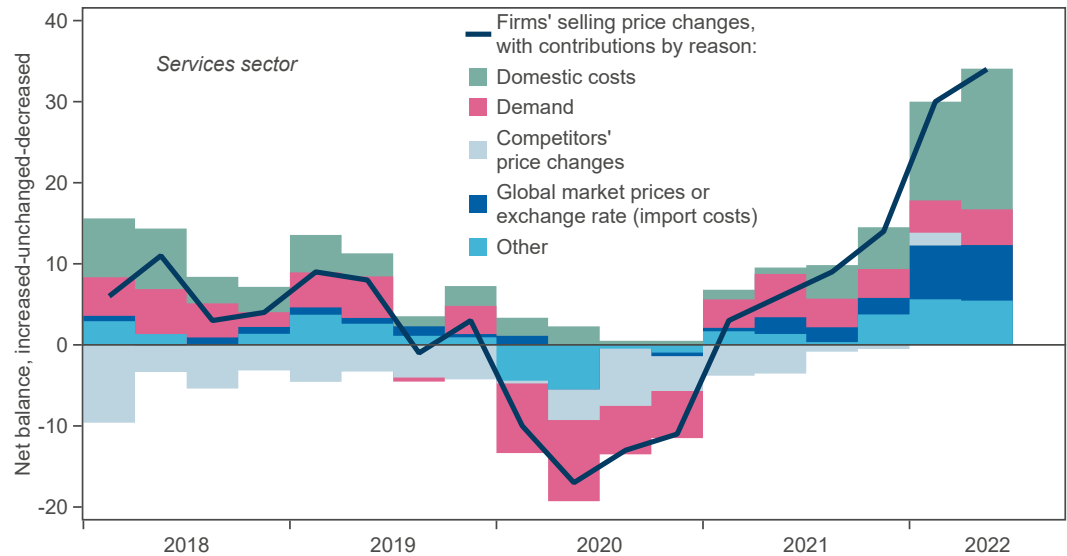
Inflation outlook: Handelsbanken vs. Riksbank



Sources: Macrobond, Statistics Sweden, Riksbank and Handelsbanken

Service sector firms' reasons for price changes

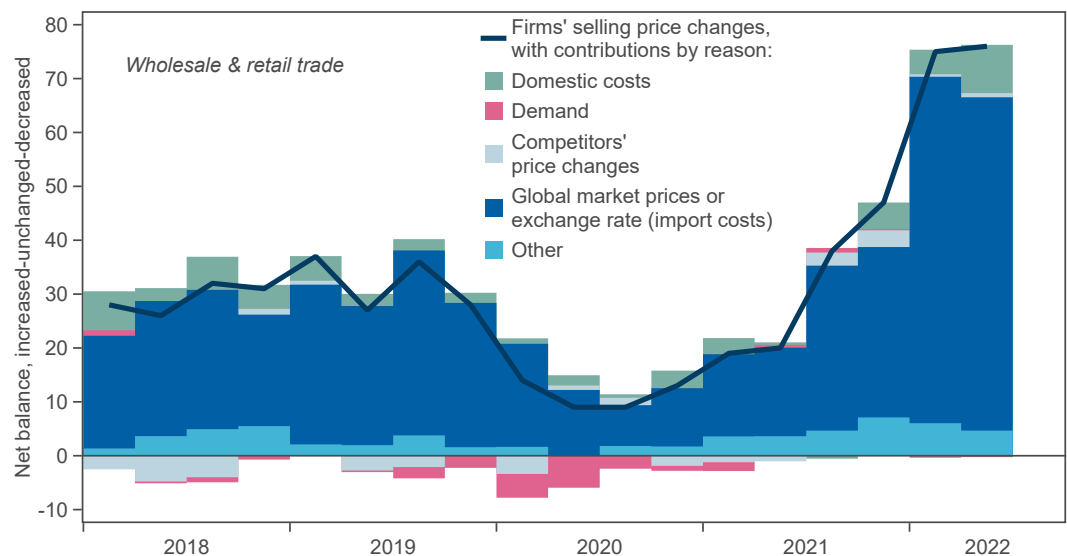
Multitude of reasons behind price increases, and not even...



Sources: Macrobond, NIER and Handelsbanken

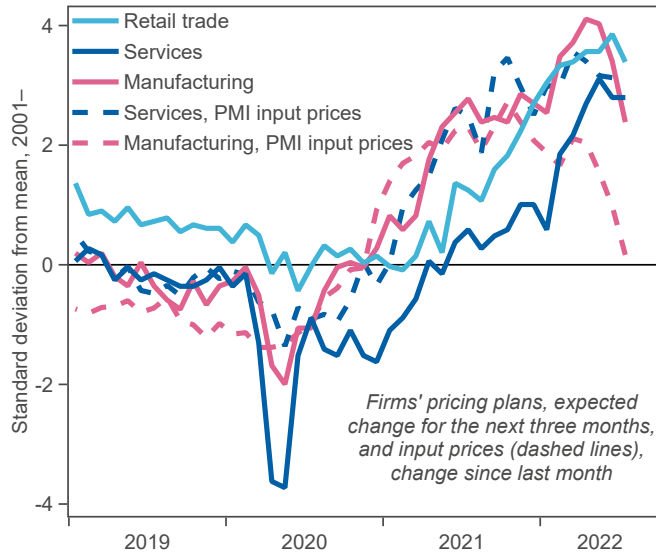
Wholesale & retail firms' reasons for price changes

...competitors' pricing have dampened firms' price rise need

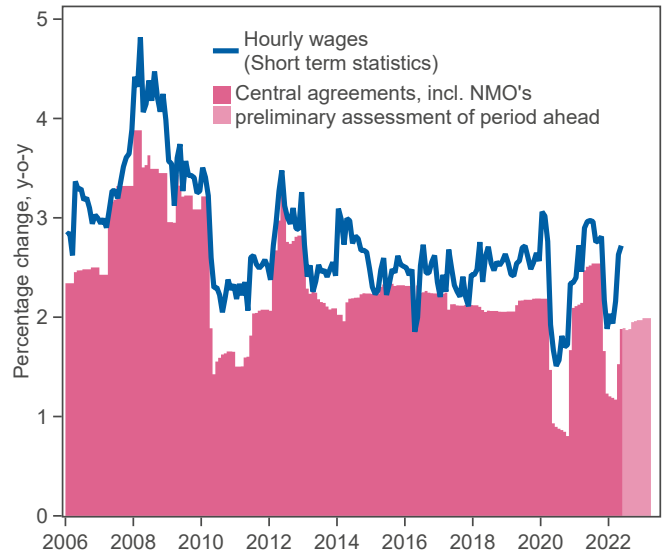


Sources: Macrobond, NIER and Handelsbanken

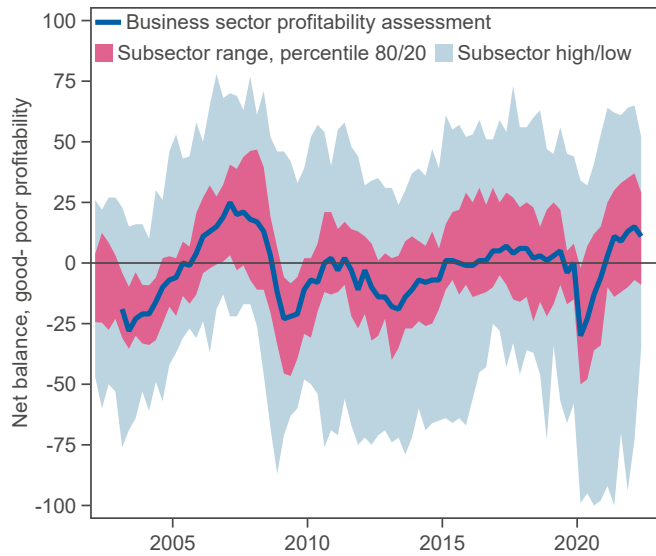
Pricing plans remain high; factory input price rises ease



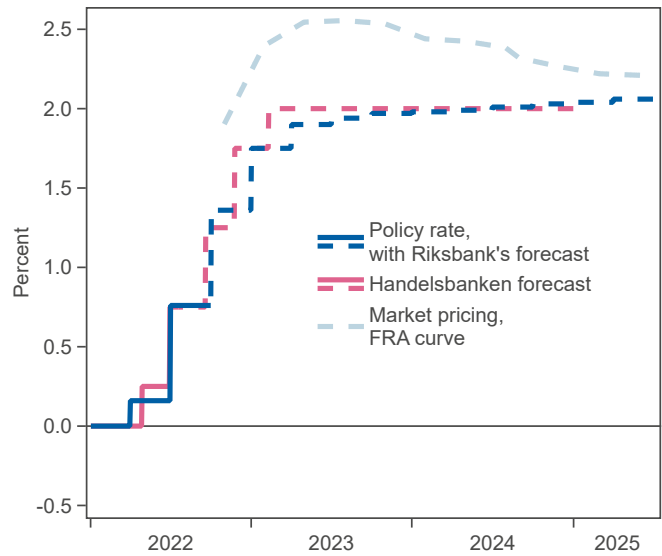
Wage increases drifting higher than central agreements



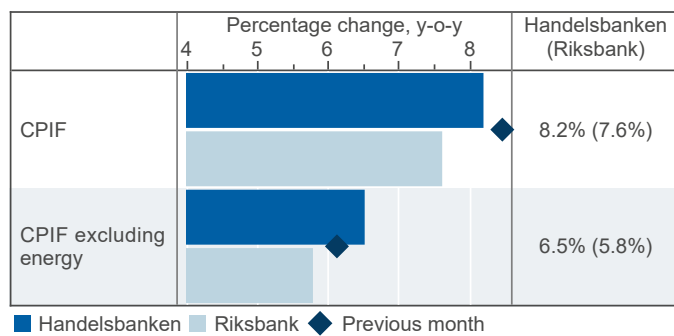
Firms' profitability good; costs passed on to customers



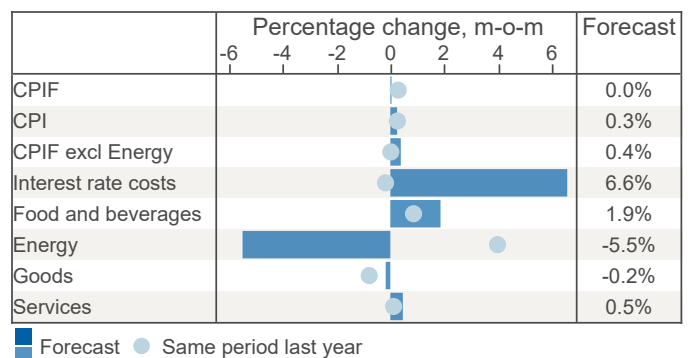
Market pricing more rate rises than Riksbank forecast



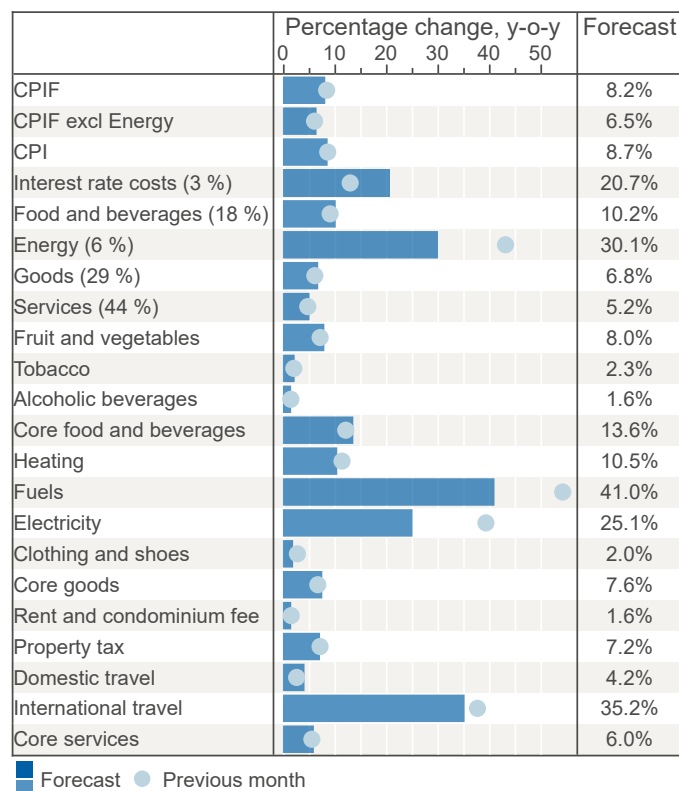
CPI July: Headline inflation eases due to energy prices



CPI July: Except energy, major price aggregates pick up



CPI July details: Food prices up 10 percent



Sources: Macrobond, Statistics Sweden and Handelsbanken

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