Fast Comment Sweden

Inflation leaving Riksbank behind – now a 75 bp rate hike awaits; July CPI report

- CPIF eases to 8 percent, but CPIFXE picking up to 6.6 percent widens Riksbank's forecast error
- Risk of runaway inflation still rising, despite turnaround in some indicators
- We change our Riksbank call to a 75 bp policy rate hike in September

CPIFXE picking up to 6.6 makes Riksbank's forecast error widen

The July CPI report shows the gap between underlying inflation signals and the Riksbank's forecasts widening further. We judge that this forecast error and, first and foremost, the current inflation outlook and risks will make the Riksbank tighten policy faster than it has so far communicated. In July, headline CPIF inflation eased to 8.0 percent, y-o-y, from 8.5 percent in June. But the step down is hardly a signal about easing underlying inflation. Instead, it was due to cooling in the still highly elevated energy prices, while inflation in terms of CPIF excluding energy (CPIFXE) picked up and reached 6.6 percent. Additionally, our analysis suggests that such further acceleration is now a common feature among underlying inflation indicators.

Food price increases clearly surpassed the 10 percent mark, hurting low- and middle income households particularly badly. But what is even more striking is the continued broadness in this inflation surge – the prices of more or less everything are soaring.

Risk of runaway inflation still rising, despite turnaround in some indicators

The global economy is forecast to cool, many commodity prices have fallen, manufacturing firms now experience slowing price increases for inputs – and for the last few months we have been on the hunt for an inflation turning point. So why then do we judge that the Riksbank will reach the conclusion that policy tightening efforts needs to be stepped up further? Because the risk of runaway inflation may in fact still be rising:

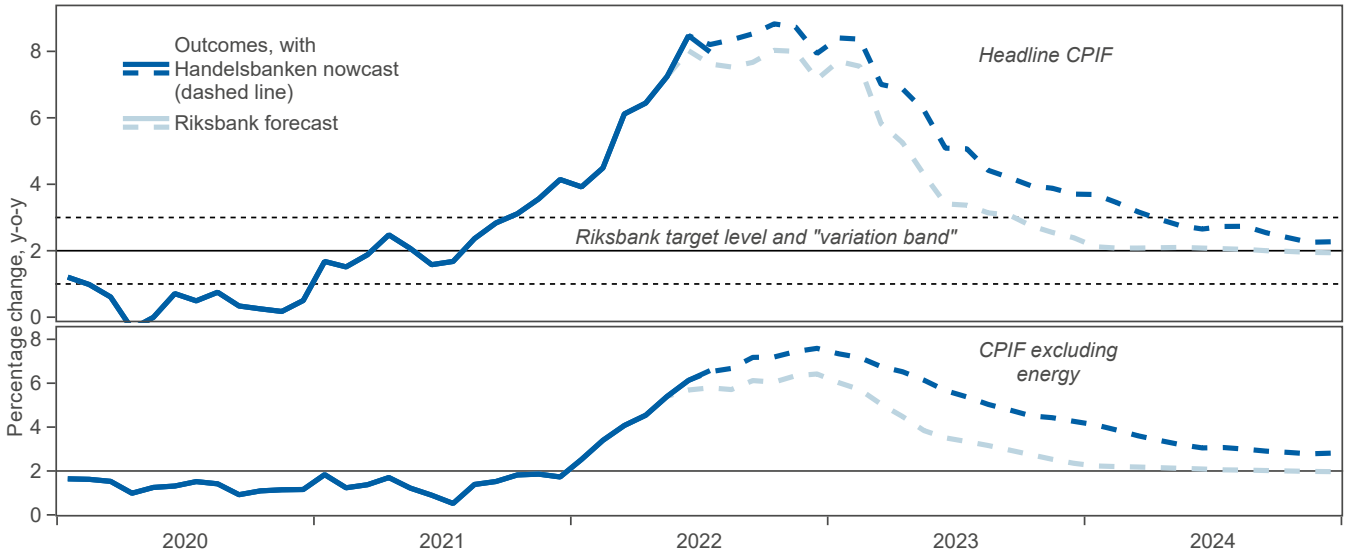
First, remember that we for a long time have argued that inflation is driven by a wide range of factors, like demand pressure, supply disruption and rising inflation expectations. Hence, even if commodity prices have now eased, inflation could remain far above the Riksbank's 2 percent target for a long time.

Second, analysing the risk of entrenched inflation through the lens of this summer's BIS report on inflation, one arguably reaches the same conclusion. One argument is that the synchronous rise in an overwhelming majority of prices is one sign that the Swedish economy, like many others, is moving toward a tipping point, where the low-inflation regime changes to a high-inflation one. And another argument is that the risk of a wage-price spiral has risen, since firms have pricing power (profitability assessments stay high), workers appear to have pricing power (signs of wage drift, hot labour market) and inflation expectations stay high. Further comments and charts here.

We change our Riksbank call to 75 bp policy rate hike in September

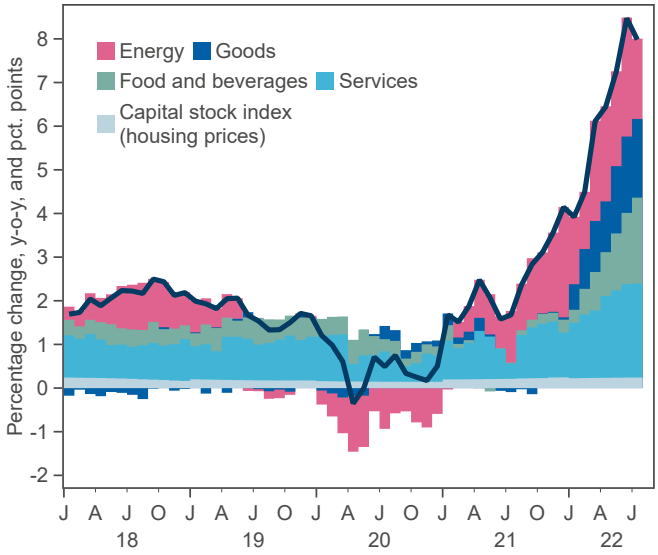
We raise our forecast for the Riksbank's policy rate, by changing our call ahead of the September monetary policy meeting to a 75 bp rate hike, from 50 bp previously. For the time being, we stick to our calls for 50 bp and 25 bp hikes in November and February, respectively, citing the high interest rate sensitivity of the Swedish economy. For this very reason, it is a also a close call ahead of the September meeting, but remember that the Riksbank has relatively few policy meetings – five a year and only two in the second half of the year – so compared with other central banks, a 75 bp hike is a somewhat less aggressive move, and instead one has to focus on the policy rate level. Our new policy rate path still implies that market-pricing for the remainder of 2022 appears to high. Markets have been pricing *more* than two 75 bp rate hikes lately.

Inflation forecasts vs. oucome



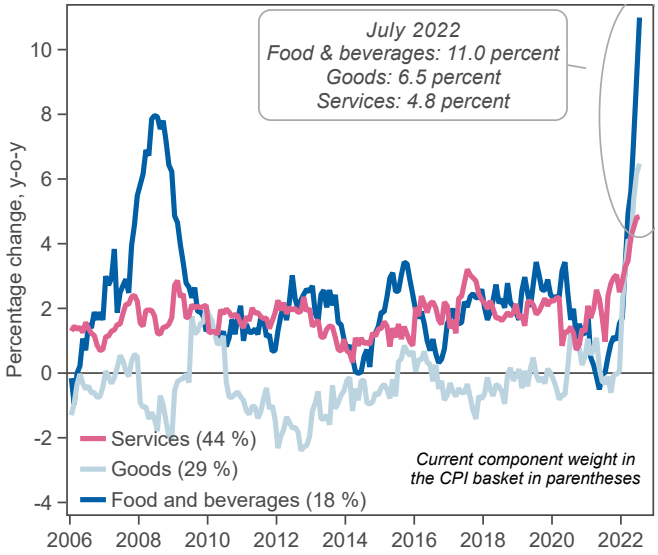
Sources: Macrobond, Riksbank, Statistics Sweden and Handelsbanken

Contributions to headline CPIF inflation



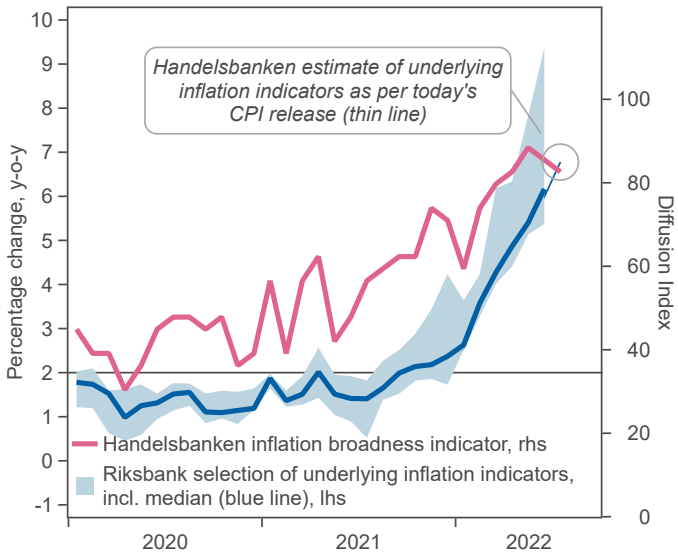
Sources: Statistics Sweden and Handelsbanken

Inflation components



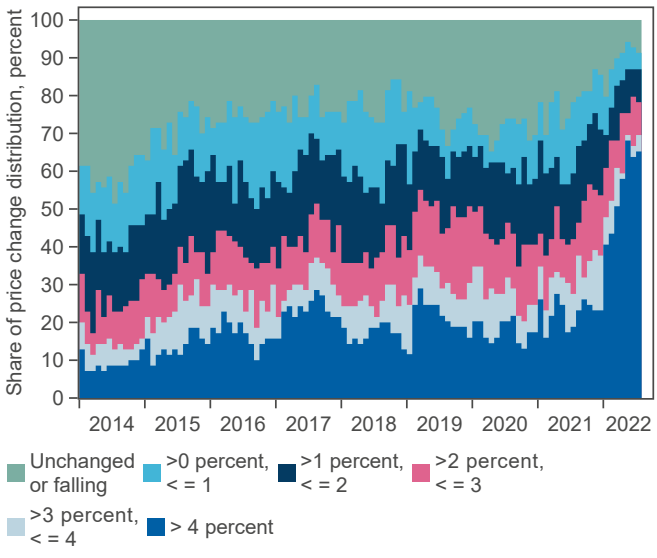
Sources: Statistics Sweden and Handelsbanken

Underlying inflation indicators soaring



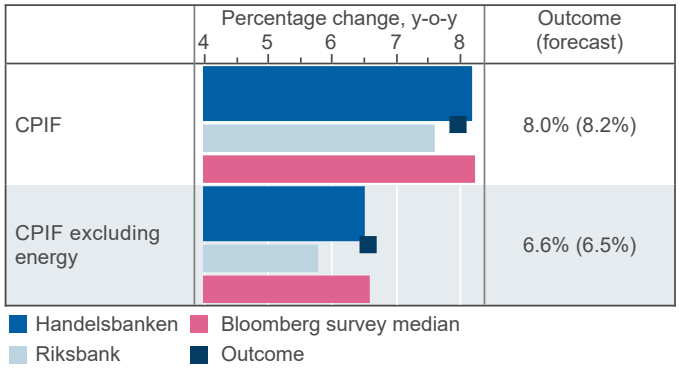
Sources: Macrobond, Riksbank, Statistics Sweden and Handelsbanken

Price rises now very synchronised

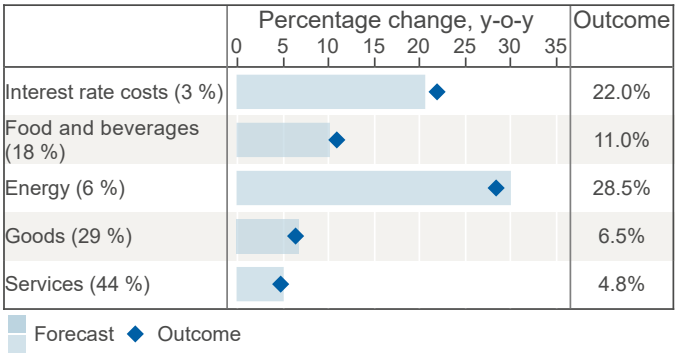


Sources: Statistics Sweden and Handelsbanken

July CPI report table



July CPI report component aggregates



Note: Component weight in CPI in brackets.
Sources: Handelsbanken and Statistics Sweden

Johan Löf

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