SPEECH

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Weak consumption and the housing market: causes and lessons learnt

The Riksbank's most recent forecast, like several other forecasts, points to good growth and low inflation this year and in the coming years. Following a period of weak demand, growth in Sweden started to pick up last year, helped by strong exports and rising private consumption. CPIF inflation, which had previously been elevated, had fallen to 2.1 per cent in December.

Despite high uncertainty, not least in the rest of the world, Sweden's economy is thus, by all accounts, currently in a relatively favourable position. It may therefore be appropriate to reflect now on the consequences of the macroeconomic shocks we have experienced in recent years, and the lessons we can learn for the future.

Today I will focus on household purchasing power and consumption, and their links to the housing market. Disposable income and consumption fell after inflation picked up in 2022 and remained weak for a couple of years thereafter, both compared with historical trends and with the euro area and the United States. Weak consumption, together with low residential investment, contributed to the weak GDP growth in 2023 and 2024.

Our economic development normally follows that of the rest of the world very closely, as we are generally affected by the same events as other countries directly or indirectly through the demand for our exports. Therefore, episodes where developments have deviated from those in the rest of the world are particularly interesting and important to understand.

1. So what can explain why Swedish households were hit harder than households in many other countries during the years of high inflation? Why have Swedish households' real disposable incomes and consumption been weaker?

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2. What impact have rising housing costs and falling house prices had on household finances and demand over the period?

3. And what do the answers to these questions tell us about future developments and lessons to be learnt?

The Riksbank's monetary policy is, of course, an important piece of the puzzle in this story, not least via the Swedish households' high debts and via the debts' short interest-rate fixation periods. I will come back to this.

Why were Swedish households hit harder than households in other countries?

Let me start with the first question: why Swedish households were hit harder than households in many other countries during the years of high inflation.

Important explanations for the weaker development of consumption in Sweden than abroad are that households' labour income has grown more slowly and that their purchasing power has been further undermined since inflation picked up at the end of 2021. The combination of a relatively moderate growth in labour income and higher inflation meant that real household income from labour declined over the period. In fact, Sweden stands out in this respect, both when compared to the major economies, the euro area and the United States, and when compared to our Nordic neighbours.

The relatively weak development of Swedish households' labour income appears to be related to wages and salaries as well as to the number of hours worked, although comparisons between countries tend to be uncertain in these respects. This development is, of course, partly about responsible wage agreements, which helped to safeguard the credibility of the inflation target in a situation where CPIF inflation was significantly higher than the 2 per cent target.

The comparatively large erosion of purchasing power in Sweden can be explained, at least in part, by the sharp depreciation of the krona in 2022 and 2023. A reasonable assumption is that the exchange rate has the largest impact on goods prices, which have risen significantly more in Sweden than in the euro area and the United States. The Riksbank's estimates and model analyses indicate that a lasting krona depreciation of this magnitude would normally correspond to just over one percentage point of the increase in consumer prices during the period.[1] In addition, there are studies indicating that cost changes have a much greater

[1] See the article "The impact of the exchange rate on inflation" in Monetary Policy Report, December 2016.

impact on consumer prices when inflation is high than when it is low.[2] It is therefore entirely possible, although by no means certain, that the exchange rate is behind almost the entire difference in the development of purchasing power between Sweden and the rest of the world since inflation accelerated.

In addition to falling real labour income, many Swedish households have experienced how interest rate changes can rapidly affect their own purchasing power. For the average household, interest costs as a share of disposable income doubled in a short period of time. This is more than in the rest of the world and is related to a relatively high level of debt and a high share of variable interest rates. However, it is worth remembering that we are talking about the average household, including the majority who have no mortgage at all. For many households, the interest-to-income ratio has thus risen significantly more.

What role have rising housing costs and falling house prices played?

Interest costs not only affect households' disposable incomes, but also have an impact on the housing market, as they are an important component of the cost of owning a home. Housing costs, in turn, play an important role in determining house prices. It is usually assumed that the price of homes is determined by what people think it will cost to own them.[3] Expectations of future value increases also enter into this kind of housing cost calculation. Before the interest rate hikes, it was probably quite common to have very optimistic expectations of further increases in house prices. Thus, the very expectation of continued appreciation may have contributed to house prices being as high as they actually were. When interest rates were subsequently raised and prices started to fall, optimistic expectations were dashed, which in turn may have contributed to further price declines.

Given this, it is not surprising that we have seen falling house prices in Sweden. From peak to trough, prices fell by almost 15 per cent, significantly more than in the rest of the world. In theory, it is conceivable that falling house prices affect household consumption through several different channels. Lower house prices may make it a little more difficult for households to borrow against their homes. In addition, lower prices mean that households' net wealth is falling, which in itself may dampen consumption. However, my interpretation is that the effect of

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[2] See, for instance, the article “The pass-through of the krona to inflation appears to have been larger than usual”, in Monetary Policy Report, November 2023, and Linderoth and Meuller (2024).

[3] See Almenberg et al. (2022). At least in theory, it should be a question of how these costs are expected to develop over the lifetime of the house, which means that if households expect a rise in interest rates to be temporary, it will have less impact on house price developments. However, one possibility is that the rise in interest rates after 2021 has led many to adjust their expectations regarding mortgage rates further ahead, too.

higher interest expenditure is at least as important an explanation for the weak consumption growth.[4]

Residential investment also reacted to interest rate changes and falling house prices. While housing investment represents a small share of total investment, it tends to vary widely. In recent decades, it has tended to amplify economic downturns, particularly after episodes of interest rate increases. The period I have focused on today is no exception to this. In fact, Sweden is one of the countries that has seen the biggest fall in housing investment, a fall unrivalled since the 1990s. Housing investment has contributed negatively to GDP growth by a total of almost 2 percentage points in 2023 and 2024.[5]

Consumption trends going forward

To summarise, the contributing factors to the comparatively weak development of consumption are thus: responsible wage agreements, the weakening of the krona and Swedish households' high sensitivity to interest rates. In addition, the sharp decline in house prices has probably played a role.

When we now look ahead, we have good reason to believe that disposable incomes will rise because interest rates are lower and real wages are rising. We therefore assess that we have a stable upturn in consumption ahead of us. This year and next, we expect household labour income to rise by more than 4 per cent a year as wages continue to rise while unemployment falls back. At the same time, the share of labour costs in the total value added of the business sector is at a comparatively low level to start with. The conditions are therefore favourable for real wages to rise at a good pace in the future, without cost pressures increasing in a way that is incompatible with the inflation target.

In addition, the krona has strengthened again and this is now helping to dampen inflation. Last year, the krona appreciated by around 5 per cent against the euro and by over 15 per cent against the US dollar. The future development of the krona is, as always, uncertain, but over the past six months the exchange rate has remained stable despite persistent international concerns. This year, there is also the effect of the halving of VAT on food, which will temporarily push down inflation and contribute to a strengthening of real household incomes.

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[4] These are also conclusions that can be drawn from several recent studies, including Flodén et al. (2021) and Bojeryd et al (2026).

[5] Part of residential investment consists of imports, which means that the actual contribution to GDP growth is somewhat smaller in absolute terms.

Monetary policy in the high-inflation years and beyond

The high interest rate sensitivity of households that I have mentioned several times today is of course directly linked to the Riksbank's policy rate. I would therefore like to say a few words about the monetary policy we conducted during the years of high inflation, and how we at the Riksbank assess that interest rates will develop in the future. As you know, the Riksbank and many other central banks raised interest rates in 2022 and 2023 to bring inflation back down. At the beginning of the upswing in inflation, we assessed that comparatively modest interest rate increases would suffice. The relatively high interest rate sensitivity of Swedish households suggested that even fairly modest increases in interest rates would produce a significant tightening.

However, the inflation outlook deteriorated repeatedly in 2022 and 2023, partly because the krona continued to depreciate in 2023 in a way that we had not expected. The depreciation added to the already high inflation rate and, in addition, several analyses showed that the pass-through of the exchange rate to consumer prices was likely to be higher when inflation was high. To tackle inflation, we needed to raise interest rates more than we initially thought necessary and almost as much as the rest of the world.

Of course, the cuts in the policy rate since May 2024 have improved the financial situation of many households, especially those with large loans. The share of interest payments in household disposable income has fallen back from around 7 per cent in 2024 to around 5 per cent today. Our forecast is that the policy rate will remain roughly at the current level going forward.

Lessons from the years of high inflation and high interest rates

With the benefit of hindsight, we can conclude that the interest rate hikes did not cause a collapse in consumption. It can be argued that the system was never as vulnerable as some feared, and I think there is some truth in this. One reason is probably that savings have long been high and many households therefore had a buffer of savings that they could use when interest rates rose.

But it must also be remembered that the world's stock markets have been relatively stable during the years of high interest rates and that the Swedish labour market has long withstood the downturn fairly well. In this sense, the recession was not as broad, which also contributed to the fact that consumption did not fall as much as might have been feared.

Moreover, it is worth emphasising that the combination of amortisation requirements, mortgage caps and banks’ credit assessments has contributed to household resilience and thus strengthened financial stability. It is impossible to say exactly how much impact different measures have had on increasing household resilience, but I am convinced that the effect has been positive. What seemed almost improbable during the low-inflation years became a de facto reality; mortgage rates rose to levels that were then seen by many as unrealistic. So an important lesson is to recognise that reality can change rapidly.

We have also been reminded of our strong dependence on other countries. The Riksbank's monetary policy is designed to suit Swedish conditions, but both inflation and economic prospects are determined to a considerable extent by international conditions. How economic changes in the rest of the world affect Sweden is determined to some extent by the krona exchange rate. In previous recessions, the exchange rate has in many cases acted as a kind of shock absorber, as small currencies like the Swedish krona usually weaken when international economic activity weakens. In such a situation, a weakening of the krona helps to reduce the decline in Swedish inflation and demand. But this time the macroeconomic circumstances were different. In 2023, the weak krona pushed up the already high inflation even further and contributed to our decision to raise the policy rate to 4 per cent, which had an impact on many households with large loans.

Another clear and important lesson learnt from the years of high inflation is the value of maintaining the credibility of the inflation target. We could see that responsible social partners took the inflation target of 2 per cent as their starting point in wage formation, despite inflation rising to over 10 per cent in the short term. This has cost households purchasing power in the short term, but it is something that will benefit the Swedish economy and Swedish wage earners in the long term. The credibility of the inflation target contributes to stability and predictability and paves the way for rising real wages in the coming years.

At the Riksbank, we have also learnt lessons from the turbulent developments of recent years for our own analytical work. We are now putting a lot of effort into developing our forecasting models and actively discouraging groupthink. I hope that we at the Riksbank will not miss the signals if inflation were to rise sharply again.

It is also possible to draw conclusions regarding the regulatory frameworks and norms around indebtedness that I have just mentioned. The fact that we in Sweden deviate with large debts and such a high proportion of variable loans is not optimal and constitutes a vulnerability in the economy. Reality can change rapidly. That is why it is so important that we retain clear regulations and standards for household indebtedness and safeguard the amortisation culture that is now beginning to take hold. One can also hope that more people will be willing to pay the insurance premium of locking in mortgage rates for a longer period.

Finally, it would be desirable for housing construction to be less cyclical and more sustainable, as is the case in other countries. Major downturns have a negative impact on the labour market, skills are lost and housing policy becomes erratic. There is a need to go deeper and analyse the causes. Among other things, it should be considered whether the volatility in residential construction is partly due to the fact that current business models are designed on the assumption of ever-increasing house prices.

At the moment, the signals from the Swedish economy are positive, with inflation close to our target and growth having started to pick up. But it is not difficult to find reasons why developments might take a completely different turn to what we believe and hope for. However much we try to improve our ability to anticipate and counteract severe macroeconomic scenarios at an early stage, they are not entirely avoidable. I hope that households, banks and other actors do what they can to ensure that the Swedish economy is well prepared when this happens.

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