A hawkish hold in Sweden, but scope for more tightening is limited

The Riksbank paused, but inflation and currency-related concerns prompted policymakers to threaten another hike and open the discussion on faster bond sales. However, we don't forecast any more hikes, given the deteriorating activity outlook. We still expect SEK strength next year, but a bumpier appreciation path after today

Erik Thedéen is Governor of the Riksbank

Growth concerns prompt a pause

The Riksbank announced today that it will be keeping the policy rate unchanged at 4.00%. Expectations had swung increasingly in favour of a hold in the runup to the meeting, following a soft inflation reading accompanied by a strengthening in the SEK on a trade-weighted basis over the last few weeks.

The growth outlook in Sweden remains grim; house prices have started to drop again and consumer confidence remains gloomy. The jobs market – often cited by policymakers as a clear area of resilience – does appear to be cooling while showing signs of concern. Vacancy levels have fallen by 30% from the same period last year, unemployment appears to have bottomed, and surveys show that a lack of labour is much less of a constraint for businesses than it was a few months ago.

There's still a hawkish bias given inflation risks

The latest core CPIF reading was more-or-less in line with the Riksbank's forecast, even if it decelerated less than consensus. Core inflation is running at 6.1% and the Riksbank kept highlighting it is too high and there are risks its decline may be slower than expected.

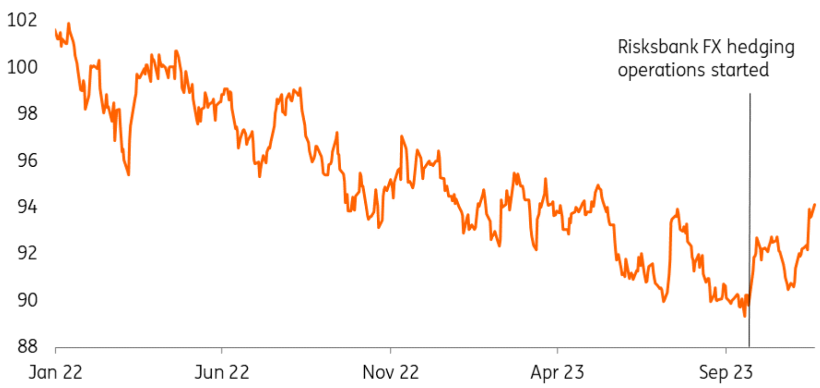
Lingering inflation concerns convinced the Riksbank to strike a hawkish tone as they paused the hiking cycle for the first time since February 2022. The statement clearly points at the possibility of another hike if inflation fails to decline in line with the Bank's expectations and the rate projections keep showing a 4.10% peak. Incidentally, the Riksbank reinforced its narrative about higher rates for longer and signalled an acceleration in quantitative tightening will be discussed at the next meeting (announcement on 1st February).

Krona's performance remains central

In our view, the recovery in the krona played an important role in tilting the balance towards a hold. SEK has appreciated by around 4% on a trade-weighted basis since the September meeting, largely benefitting from the FX hedging operations conducted by the Riksbank itself. Since those hedging operations are due to end around January/February (if the current pace of FX sales is maintained), we had pointed to the fact that another boost to the currency via a hike would have likely helped a smoother SEK recovery into 2024.

The Riksbank reiterated that SEK remains unjustifiably weak which could be contributing to holding prices up above the 2% target, and opening the discussion to increasing the pace of government bond sales likely aims at offering support to the krona. In practice, this pause in the tightening cycle means SEK will likely be more vulnerable and rely more on external factors or the pace of the Riksbank's FX sales to stay on an appreciation path.

SEK has strengthened, but Riksbank FX hedging has played a role



Source: ING, BIS

We don't expect another hike

The intent to keep offering support to the krona is the key incentive to keep the Riksbank communication hawkish and leave the possibility of a rate hike open until the next meeting. However, the next policy announcement is in February, when any hawkish narrative may well be challenged by evidence of a deeper economic slump; we estimate the Swedish economy will contract by 1.4% QoQ annualised in 4Q23. Incidentally, we expect some improvement in external conditions for high-beta currencies like SEK thanks to lower US yields in 1Q24, meaning SEK may not be facing excessively severe selling pressure by February.

All in all, we are inclined to think this was the last opportunity for the Riksbank to hike, and the tightening cycle in Sweden is over. Markets agree with this view and are only pricing in a marginal probability of another rate rise. An acceleration in bond sales in February looks likely though, and the Riksbank will likely focus on fighting rate-cut speculation. Still, we forecast the easing cycle in the eurozone - and in Sweden - to start in September 2024.

EUR/SEK forecasts unchanged

From an FX perspective, today's Riksbank decision has not convinced us to make any changes to our EUR/SEK forecasts. We have called for a correction in high-beta currencies after the post-US CPI rally, and we have a modest bullish bias on EUR/SEK into year-end, where we could see a return of levels around 11.60.

The lower carry (by 25bp compared to our previous expectations) should not be a game-changer in 2024 for SEK. The krona is undervalued and has plenty of room to recover on the basis of long-term economic fundamentals without the need for a particular carry advantage. Should our baseline scenario of a benign USD decline and generalised support for pro-cyclical currencies materialise next year, then EUR/SEK should be able to hit 11.00 before year-end 2024.

Where today's Riksbank decision may end up having an impact on the SEK outlook is in the periods of risk-off corrections. The change in stance by the Riksbank makes SEK more vulnerable, especially in the near term, meaning the depreciation path may be bumpier.

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