

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.

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by

the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.