

Cautious Riksbank may add pressure to krona

We expect Sweden's Riksbank to hike rates from late 2023, though policymakers are likely to remain reluctant to endorse much - if any - tightening when the Bank meets this Thursday. Despite the recent rally, EUR/SEK is not overvalued in the short-term, and a cautious Riksbank announcement may generate more SEK weakness this week



The Swedish krona has appreciated over 5% against the dollar and around 3.5% against the euro since the end of January

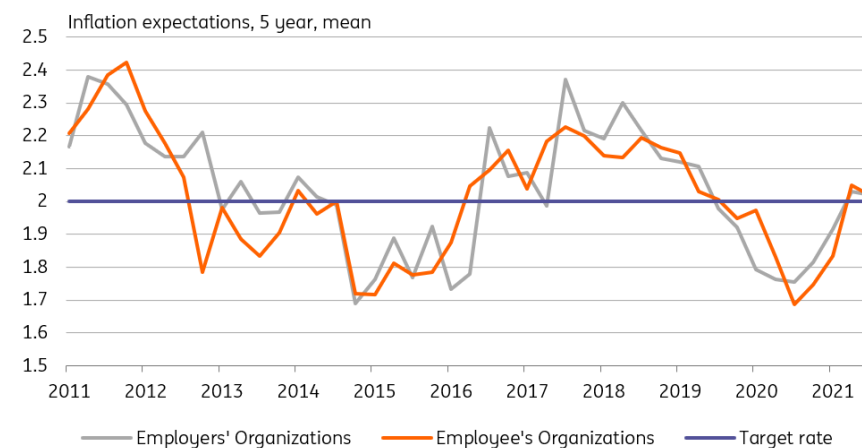
Riksbank to stay cautious, despite solid economic backdrop

This week's Riksbank meeting has the potential to be more interesting than most. This is not because policymakers are likely to do anything – indeed they have made it pretty clear they won't be joining the club of central banks hiking interest rates in the next couple of years – instead, the focus will be on the central bank's intentions in 2024.

That's clearly a long way off, though our own view is that the Riksbank is likely to have hiked, potentially more than once, by the end of that year. Our forecast for the first rate hike in late-2023 tallies with what our team is expecting from the European Central Bank.

So far, the Riksbank has been resistant to include a rate hike in its published rate projection, which as of September went out as far as 3Q 2024. That might change this week, with the inclusion of a notional rate rise for the final quarter of 2024, though even that isn't totally guaranteed.

The economic backdrop would justify hints of very modest tightening. Indeed, by one measure of unemployment from the Public Employment Service (PES), the rate is not far off pre-virus levels. Labour demand indicators and business confidence is high, and the backdrop for a better negotiated wage outcome in 2023 is reasonable.



That's not to say that the Riksbank faces any imminent threat of a serious wage spiral – and that's fairly clear when looking at long-term inflation expectations. Both employer and employee organisations involved in wage setting see five-year inflation rates around target.

The challenge for the Riksbank, like many other central banks, is that markets have begun to price in rate hikes much earlier than policymakers are hinting. Investors are looking for at least one rate rise next year, and policymakers will no doubt be wary that including a rate hike in its projections – even one as far away as 2024 – could reinforce some of these expectations. The latest rise in Covid-19 cases across Europe adds another potential reason for caution this week.

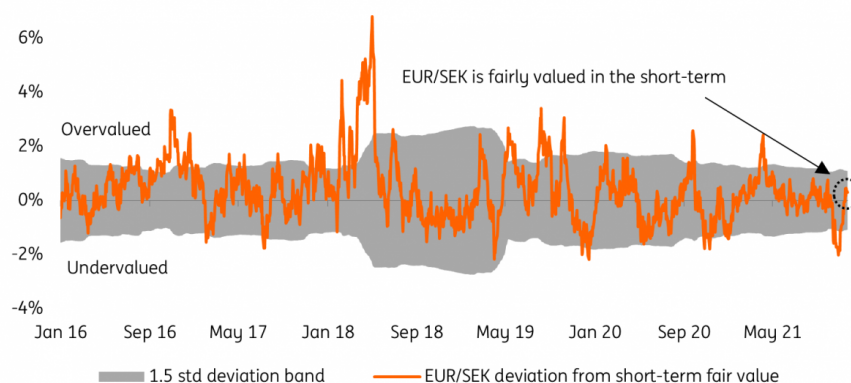
That caution probably means it is also too early to hear about the Bank's balance sheet plans beyond next year. The Riksbank has said it will reinvest to keep the size of its bond holdings unchanged in 2022, after the QE programme wraps up this quarter. We suspect policymakers will allow a gradual reduction in bond holdings thereafter. But this is probably a story for a later meeting.

FX: Riksbank unlikely to rescue the krona

Scandies have been the worst performing currencies in the G10 over the past month, and despite the recent EUR weakness, EUR/SEK has recovered almost all of the October losses and is now trading around 10.12. The recent rise in Covid cases in Europe and fresh restrictions being imposed in Austria and Germany are likely worsening the already choppy environment for SEK, which has an historically high beta to EU-related sentiment (Sweden's economy highly relies on intra-EU trade).

Despite the recent rally in EUR/SEK, the pair is not showing signs of overvaluation, according to our

short-term fair value model (chart below). That is due to the fact that the October rally in SEK was not justified by equal moves in its short-term drivers (front-end rates, shape of the yield curve, equity performance, risk sentiment), so SEK moved into expensive territory against the EUR. The recent SEK underperformance was simply a re-alignment to its equilibrium level, and there's little to suggest the EUR/SEK rally is overstretched.



Source: ING, Refinitiv

As discussed above, we expect the Riksbank to push back against market speculation that the tightening cycle will start as early as 2022. Despite our view that policymakers won't be able to delay tightening beyond 2023, the Riksbank is likely aware that adding a 2023 rate hike to their current forecasts will be a de-facto confirmation that hawkish bets are warranted and would likely cause a hawkish re-pricing in the SEK money market.

Given the non-alarming inflation outlook and recent CPIF expectations remaining relatively anchored, we think the Riksbank will disappoint hawkish expectations this week, and we expect some dovish re-pricing of rate expectations. In FX, this should translate into more SEK weakness in our view, although losses should be more marked against the USD than against the EUR. Still, EUR/SEK may approach the 10.20 level this week.

Looking beyond the short-term, a quite strong negative seasonality for EUR/SEK in December suggests the pair could gradually converge to the 10.00 level again by year-end. That is, however, conditional on the ability of EU countries to face the new Covid wave without strict containment measures.

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

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.