

Riksbank goes big, but the Swedish krona remains troubled

Sweden's central bank hiked the repo rate by 100bp to 1.75% today and signalled more tightening is on the way. The krona's reaction was negative though, as monetary policy keeps proving a secondary FX driver and the Riksbank's reserve build-up remains under scrutiny amid a generalised bad environment for high-beta European currencies

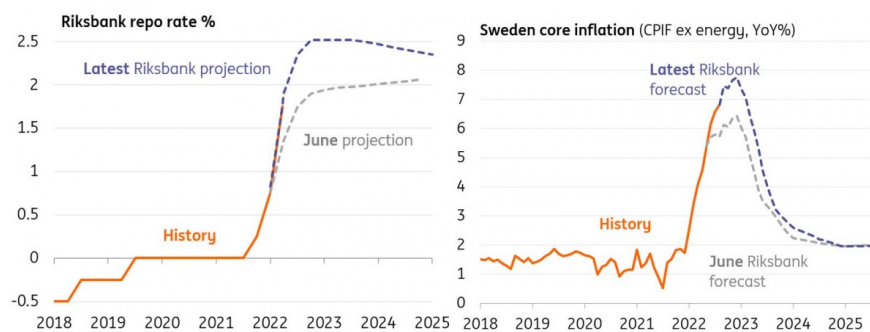


100bp hike and an updated rate profile

Sweden's Riksbank has hiked rates by 100bp taking the repo rate to 1.75% – the biggest hike ever since the initial introduction of inflation targets. The decision to hike by 1% was unanimous, prompted by the highest level of CPI inflation since 1991 and the negative implication it could have on the upcoming wage negotiation which will lock in pay growth for the next three years.

Looking at officials' new interest rate projections, they are signalling a further 25bp hike at the November meeting and that rates will be around 2.50% in mid-2023. It looks like, as of now, with

uncertainties regarding inflation remaining high throughout the winter, the bank accepts the housing market slowdown in the medium-short term, prioritising bringing down long-term inflation risk instead.



Riksbank's new projections

Our forecasts for Riksbank and the krona

We think the Riksbank may deliver more front-loading (so a 50bp hike) in November compared to what is embedded in the rate path projections (25bp). Indeed, Governor Stefan Ingves stressed that policy decisions will be taken on a meeting-by-meeting basis, hence reducing the relevance of rate projections. It's clear that further rate decisions will heavily rely on the energy story and the European economic outlook.

As discussed in [our most recent SEK update](#), a more hawkish Riksbank would hardly translate into a stronger krona in the near term, both because the relation between short-term rates and FX has waned across G10, and because the energy crisis in Europe should keep high-beta European currencies like SEK vulnerable. Today's reaction in EUR/SEK was a case in point: an initial drop after the larger-than-expected hike was quickly followed by strong buying and the pair jumping above pre-meeting levels.

Another factor that has likely contributed to the bad SEK reaction was the reiteration by Ingves that the Riksbank will continue to build FX reserves (i.e. selling SEK mostly against USD and EUR) at the same pace. This has been seen by markets as a bearish factor for SEK lately, and we cannot exclude that the larger hike was meant to partly offset this factor.

We continue to see upside risks to EUR/SEK in the near term, especially if the 10.86 March high is broken – basically leaving the 2020 (11.00+) market crash highs as the next key resistances for the pair. We remain cautiously optimistic about a SEK recovery in early 2023, along with other pro-cyclical currencies, and see room for a return below 10.50 in EUR/SEK. The timing and the likeliness of this SEK recovery are however highly uncertain and largely depend on the energy crisis and general risk sentiment.

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