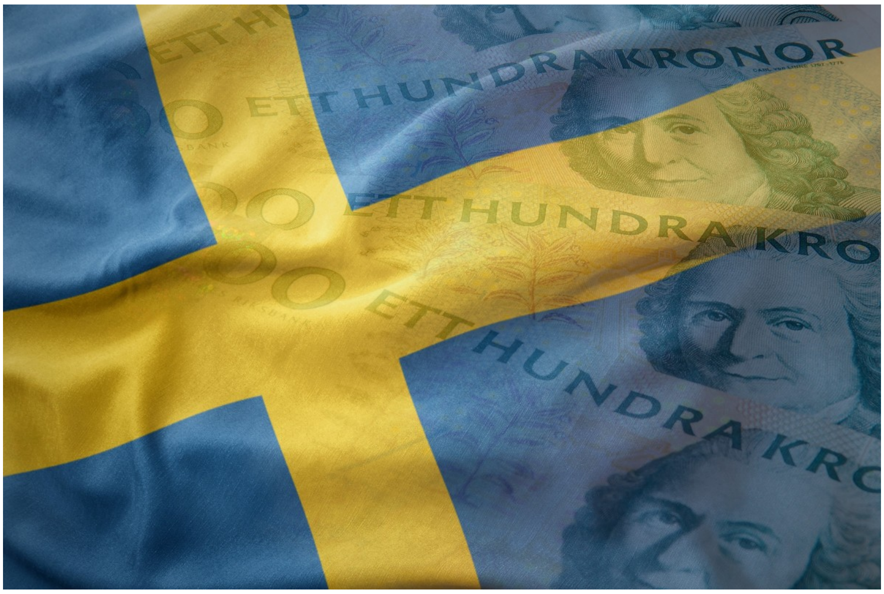
Sweden: Hard to pick a bottom for the unloved krona

In line with our call, SEK is facing increasing pressure now that the Riksbank has implicitly lifted its support. We struggle to pinpoint a top for EUR/SEK now, but more pressure on the krona could see the Riksbank step in, even if their FX-support capabilities are limited. SEK recovery path remains very narrow, and almost fully dependent on market dynamics



Read our latest article on this topic here: "Sweden: How the Riksbank has made the krona's path to recovery even narrower"

EUR/SEK breaking through the highs

Losses in the krona over the past week have exceeded those of any other G10 currencies, even those of NZD – which dropped over 2% yesterday after a big dovish surprise by the Reserve Bank of New Zealand. We are not surprised to see this happening, and we had actually called for material upside risks to the 11.50/11.60 area in EUR/SEK last week in this note, where we discussed how the Riksbank dovish turn at the April meeting had left the krona without any real support in the near term, and likely encouraged speculative shorts.

One key problem for SEK is that its main reference cross, EUR/SEK, does not have any close technical resistance at the moment. The breach of the 11.43 multi-month high meant that we are now in 2009 territory. The next key resistance level is the 11.68 historical high from May 2009.

EUR/SEK dangerously close to historical highs

Source: ING, Refinitiv

Hard to see a rebuilding of Riksbank support

Another key issue for SEK at the moment is that a return of that support by the Riksbank that had been the norm until the April policy meeting is not looking very likely. The two members that voted against a 50bp hike in April – and in our view essentially lifted support to SEK – saw their arguments for a dovish turn endorsed by more benign data on inflation and inflation expectations.

The main tool the Riksbank had to support its currency was a resolutely hawkish rhetoric: since that can hardly be fully built back now that data confirmed the doves' arguments, it's probably up to the market to turn in favour of the krona.

Our baseline scenario is that markets will turn more benevolent to high-beta currencies (especially the highly undervalued Scandinavian ones) in the second half of the year, but the ride to a recovery for SEK, which has to deal with unfavourable domestic drivers (troubled housing market, grim economic outlook), is likely to be very bumpy.

> The Riksbank may have set an imaginary line in the sand for EUR/SEK where it will decide to deploy some verbal intervention – potentially in the form of FX intervention threat. That could be the historical high at 11.68 or even higher around 12.00. It's important, however, to note that Sweden does not have enough FX reserves to enter a sustainable FX intervention campaign in a volatile market environment, which is why we believe that a threat of FX intervention may not be followed by an actual deployment of market intervention.

Domestic risks can't be ignored

A break through historical highs and a potential move close to the 12.00 mark are not part of our baseline scenario for the moment. At the same time, it would not take much more than a continuation of the risk-off we have witnessed recently for some to drive EUR/SEK to new historical highs even without markets adding much SEK-specific risk premium into the pair. That risk premium may, for example, be related to a housing market collapse, similar to what had happened in early 2023: should that be added to the recent SEK woes, the upside risks for EUR/SEK could become even wider.

Market troubles beyond what has already been reasonably priced in by the market and forecasted by the Riksbank aren't what we expect either, but investors probably have an exacerbated sensitivity to Swedish news at this stage, and we must remember that earlier in May one of Sweden's largest landlords, SBB, faced a debt downgrade to junk and had to suspend dividends. An earlier end to the Riksbank hiking cycle (June's 25bp hike should be the last one, according to projections) should at face value bode well for the battered property market, but the lagged effect of the currency-support oriented tightening suggests we have not seen the bottom for house prices yet.

It's up to the market to turn the tide for the krona

To sum up, the near-term outlook remains grim and it will almost entirely be up to market dynamics to change the tide for the krona. We think EUR/SEK could trade within a volatile 11.40/11.60 range into and shortly after the 29 June Riksbank meeting. The best news for SEK would probably be an upside surprise in May inflation numbers, that could help the Riksbank sound more hawkish.

We are keeping our year-end forecast around 11.00 for EUR/SEK, primarily on the back of the narrative of a rotation from the dollar back into European currencies in the second half of the year due to a slowdown in the US economy and aggressive Fed rate cuts. SEK has a high beta to European sentiment – which we expect to be good in 2H23 – plus it's deeply undervalued and offers an attractive carry.

But, as highlighted above, with the Riksbank dissenters having essentially lifted its main tool (a hawkish rhetoric) to support the krona, it's primarily going to be a market sentiment story in our view. And this is assuming that none of the domestic risks for SEK, which are higher than peers like NOK and the EUR, materialise. In other words, our bearish scenario for EUR/SEK faces considerable upside risks.

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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