Riksbank preview: Still in standby mode

Continued weak inflation pressure means the Swedish central bank is likely to (yet again) signal a delay in hiking interest rates. But having said that, we think the Riksbank will keep its options open

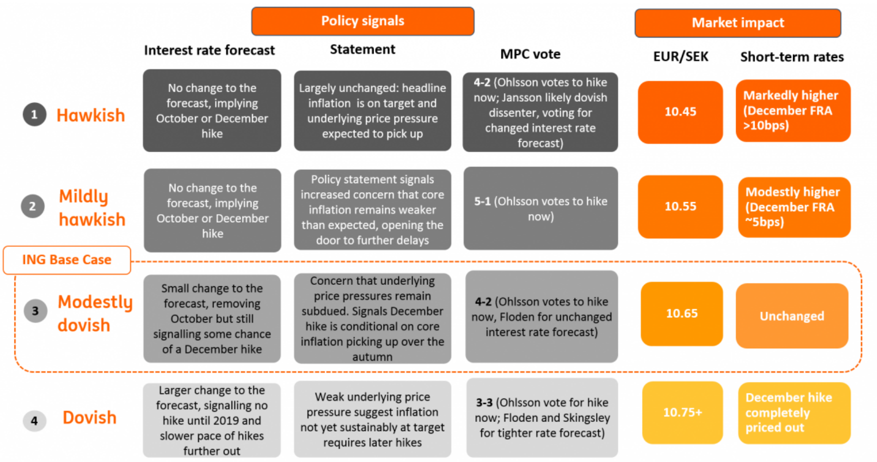
No policy change in September but a signal for later

The Riksbank is in a tricky spot, part of it is its own making. It looks to us like the committee would like to hike rates, and a ten basis point hike in December cannot be excluded. But given how adamant Governor Stefan Ingves has been that inflation needs to return sustainably to target before monetary stimulus is withdrawn, the likelihood is that further delays lie ahead.

At the Riksbank's monetary policy committee meeting, this Thursday (6 September) it is likely to keep the policy rate and asset purchase programme unchanged. But the new policy statement and interest rate forecast will be important signals for the path of policy later this year.

We think the most likely outcome is that the committee shifts its forecast of interest rates to indicate a slightly later rate hike. But the current situation is not clear-cut, and other scenarios are quite plausible. The key reason why we favour a small change to the forecast is that we think policymakers will want to avoid committing fully one way or the other and wait to make the final decision on hiking rates until later this year.

Four scenarios for the Riksbank in September



	Policy signals: Interest rate forecast	Policy signals: Statement	MPC vote	Market impact: EUR/SEK	Market impact: Short-term rates
1 Hawkish	No change to the forecast, implying October or December hike	Largely unchanged: headline inflation is on target and underlying price pressure expected to pick up	**4-2** (Ohlsson votes to hike now; Jansson likely dovish dissenter, voting for changed interest rate forecast)	10.45	Markedly higher (December FRA >10bps)
2 Mildly hawkish	No change to the forecast, implying October or December hike	Policy statement signals increased concern that core inflation remains weaker than expected, opening the door to further delays	**5-1** (Ohlsson votes to hike now)	10.55	Modestly higher (December FRA ~5bps)
ING Base Case: 3 Modestly dovish	Small change to the forecast, removing October but still signalling some chance of a December hike	Concern that underlying price pressures remain subdued. Signals December hike is conditional on core inflation picking up over the autumn	**4-2** (Ohlsson votes to hike now, Floden for unchanged interest rate forecast)	10.65	Unchanged
4 Dovish	Larger change to the forecast, signalling no hike until 2019 and slower pace of hikes further out	Weak underlying price pressure suggest inflation not yet sustainably at target requires later hikes	**3-3** (Ohlsson vote for hike now; Floden and Skingsley for tighter rate forecast)	10.75+	December hike completely priced out

Source: ING research

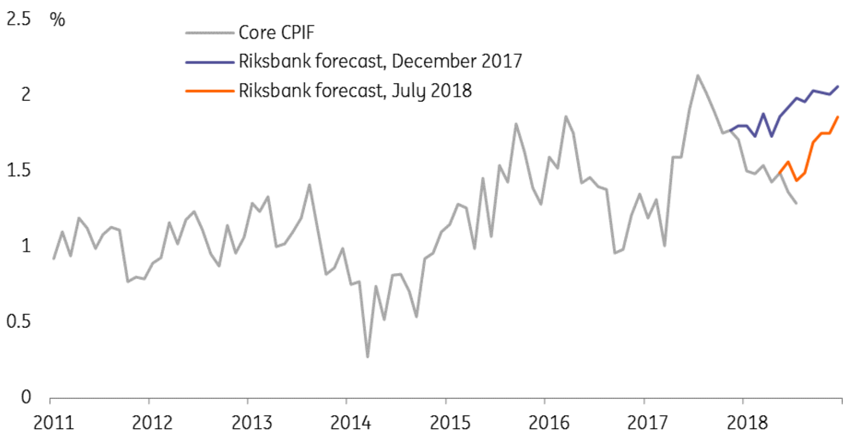
Solid growth but weak inflation pressures

The Swedish central bank is in a bind. The economy continues to grow strongly – GDP growth exceeds 3% in the first half of the year while unemployment is at cyclical lows – and the central bank would probably like to raise rates. But despite the strong economy (and a considerably weaker exchange rate), there are few signs that underlying price pressures in the Swedish economy are picking up.

While rising energy prices have pushed headline inflation above 2%, core inflation has fallen to 1.3% in July. Wage growth has hardly moved in 2018 (an estimated 2.5% annual rate over the first half of the year, compared to 2.4% in 2017).

The Riksbank's forecast for core inflation has, yet again, proven too optimistic. Both the June and July figures came in below the latest forecast. Compared to the December 2017 forecast, which expected core inflation at 2% by now, core inflation looks even more puzzling. We expect that, once again, the Riksbank will adjust its forecast for core inflation downwards.

Core inflation and Riksbank forecasts



Source: Macrobond

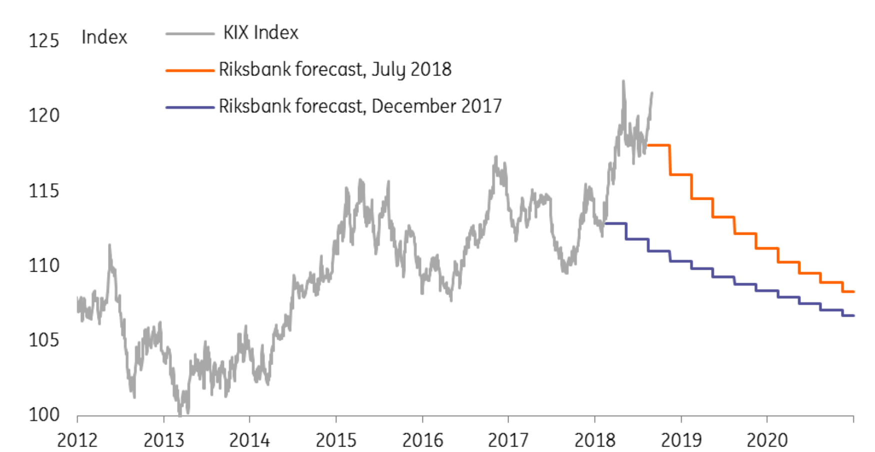
Currency weakness and turmoil on global markets

One of the more striking developments since the July meeting is the rapid depreciation of the Swedish krona. Instead of the appreciation, the Riksbank expected, the KIX trade-weighted index is now around 2% weaker than in July. This continues a pattern since late 2017. Compared to expectations at the turn of the year, KIX is now close to 10% weaker.

In some ways, this is good news for the Riksbank. Having long worried that a rapid appreciation of the krona would undermine progress on bringing inflation to target, this year's depreciation should instead boost inflation. Policymakers have not appeared overly worried by the depreciation, though it's worth remembering there was some verbal intervention in early May when EUR/SEK was around similar levels as now, and we think Governor Ingves may seek to avoid triggering further krona weakness.

Another key development is the emerging market sell-off in August, precipitated by crisis situations in Turkey and Argentina. While developed markets have held up pretty well, and the issues facing Turkey and Argentina are to a large extent idiosyncratic, the Riksbank will no doubt add emerging markets to its already long list of downside risks.

Krona trade-weighted index and Riksbank forecasts



Source: Macrobond

A divided committee

Policymakers have become gradually more divided as the year has gone on. Deputy Governor Henry Ohlsson has been voting to raise the policy rate since February, and Martin Floden signalled in July he is likely to join him soon too. Cecilia Skingsley also seems to lean towards hiking rates this year, though doesn't seem quite as urgent about it. But by December, all three are likely to vote for higher interest rates.

On the other side of the argument, Deputy Governor Jansson has long suggested continued soft inflation and the ECB's dovish policy stance means the Riksbank should not hike rates until 2019. Governor Ingves and Deputy Governor Af Jochnick have been less explicit in their reasoning but clearly, think along similar lines.

The inflation misses in June and July suggest this block of three (a majority thanks to Governor Ingves' tie-breaking vote) will move the interest rate forecast back a little to signal that policy will be a bit looser than implied by the current forecast. In our view, they want to buy some time to see whether underlying inflation can strengthen over the autumn.

If it does, then a December rate hike becomes possible. Even then, the ECB's loose policy settings and global risks such as the US-China trade war and emerging market woes could worry the doves sufficiently to delay the rate hike. If, as we think more likely, underlying inflation remains relatively weak, then the majority on committee will delay hiking rates until 2019.