

Sweden: What next for the Riksbank?

Now that the ECB has made its move, the Riksbank will have to make up its mind in December. In the end, we think it'll not add to asset purchases but will retain a dovish bias



At its last meeting two weeks ago, the Riksbank avoided taking any major decisions before the ECB announced its tapering decision. Now that the ECB has made its move, the Riksbank will have to decide in December. The minutes suggest the committee is finely balanced.

The key concern remains the currency, with the Riksbank worried about tightening policy while other central banks, especially the ECB, are in loosening mode would lead to a rapid appreciation of the SEK, which would push down inflation in Sweden. This is why the Riksbank has kept policy so loose despite the Swedish economy outperforming the euro area over the past few years.

Divisions on the policy-setting committee

In the past, the committee has been divided on the optimal policy path. Three members voted against the last two extensions of QE (December 2016 and April this year). Their argument has been the Swedish economy is performing strongly, and policy is already sufficiently loose to bring

inflation back to target. Given domestic data has continued to be strong in 2017 and inflation has now returned to the 2% target. It is hard to see these members voting for more QE in December unless there is a significant negative surprise in the data before then.

The other three members, including Governor Ingves with the tie-breaking vote, have favoured a looser stance, citing subdued inflation, currency concerns, and downside risks to the global economy to justify a looser policy stance. So the question in December largely comes down to how these three members see developments.

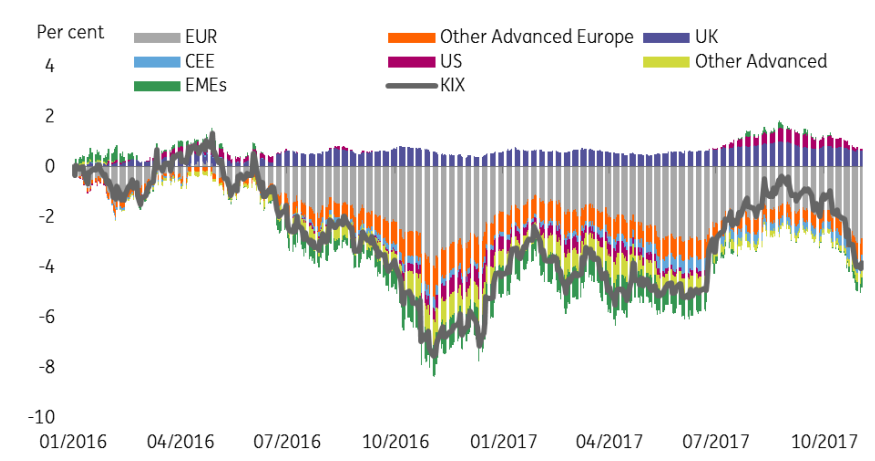
Key factors argue against an extension

None of the three doves are scheduled to speak before the December meeting. But ultra-dovish Deputy Governor Jansson has set out three conditions that need to be met before starting to phase out the current policy measure, which we think are a useful guide to the members' thinking:

Inflation steady around the target: both the headline and underlying consumer price inflation with fixed interest rates (CPIF) measures have risen in recent months and are expected to remain around the 2% target. The picture has been somewhat muddled by erratic factors though, so the October and November figures will be particularly important.

No rapid currency appreciation: the trade-weighted KIX index has fallen by around 3% since August, which should provide some comfort to policy-makers. The latest Riskbank forecasts see the KIX appreciating by 3-4% from current levels by end-2018, and a further 2% in 2019. So the currency could come up a bit from current levels without triggering too much concern.

Cumulative change in KIX trade-weighted index since 2016



Source: Macrobond

Clarity on ECB and Fed intentions: The Fed has delivered balance sheet reduction and is on track for another rate hike in December. The ECB's announcement was broadly in line with market expectations in terms of further QE purchases, but the decision to keep the programme open-ended and the tone of President Draghi's press conference remarks were relatively dovish. This makes the Riksbank's position a bit tricky because it leaves some uncertainty around when ECB will end QE and start to raise rates.

The housing market is a downside risk

Another important factor mentioned by several committee members in the October minutes is the housing market. House prices in Sweden have grown strongly for several years, leading to a rapid build-up of household debt. The Riksbank has repeatedly warned that these trends are a risk to financial stability.

The market now looks a bit wobbly as significant increases in supply and macroprudential measures to tighten lending standards weighing on prices have fallen in the past two months. There is clear concern on the committee that these developments could affect growth and inflation next year. If there are further negative developments, this could prompt the committee to delay tightening.

We think Riksbank will remain dovish

Overall, we don't think the Riksbank can justify extending QE in December, and is likely to leave the interest rate forecast unchanged. Only ultra-dove Jansson continues to advocate more QE and delayed interest rate hikes, despite the improvement in his three criteria. Ingves and Af Jochnick, the other two doves, appear comfortable with the current stance, while on the hawkish side Skingsley and Floden seem sufficiently worried about the housing market that they are unlikely to advocate faster interest rate hikes.

Instead, we think the committee will seek to minimise the risk of rapid currency appreciation by keeping communication dovish and emphasising its willingness to change course and loosen again if the situation warrants. It may also give concrete signals of a continued dovish bias. One possibility is that the first rate hike could be 10bp rather than the standard 25bps, which would keep the policy rate in line with the ECB's deposit rate for longer.

Another option could be to pre-commit to reinvesting coupons and maturing bonds for a long period, perhaps the end of 2019 or until interest rates reach a certain threshold, and to establish a smooth path for reinvestments that keeps the Riksbank buying bonds in 2018 at a reduced rate.

How the Riksbank might approach reinvestments of QE bonds

So far, the Riksbank has simply stated at each meeting that it will continue to reinvest coupon and redemption payments of the Swedish government bonds it holds. Given the ECB has provided more detail on its holdings and reinvestment schedule as the Fed and Bank of England did previously, it would make sense for the Riksbank to do the same.

An interesting wrinkle here is that the Riksbank's government bond holdings are very 'lumpy'. Few Swedish bonds are outstanding, and none are maturing in 2018. So reinvestments in 2018 would be only the coupon payments and therefore relatively small (on the order of ~SEK10bn).

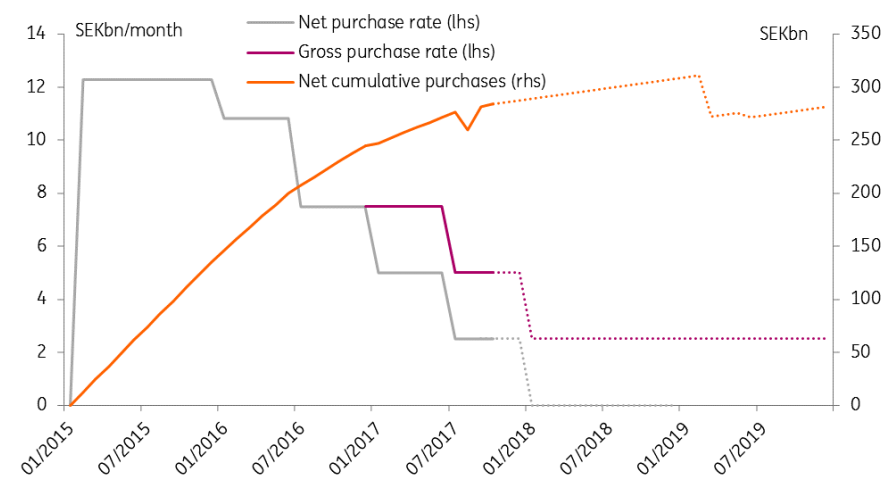
But there are two significant redemptions in 2019, of which the Riksbank probably holds SEK40-50bn worth (and another two redemptions for a similar amount at the end of 2020). In 2017 the Riksbank faced a similar situation with a single large redemption in August. At that time it

chose to spread out reinvestments totalling about SEK30bn over the whole year, smoothing the reinvestment profile.

If it were to apply the same approach to reinvestments in 2018 and 2019, that would mean purchasing perhaps SEK25-35bn of bonds in 2018 (compared to SEK75bn gross, SEK45bn net, in 2017) and a similar amount in 2019. So the amount of bonds on the Riksbank's balance sheet would temporarily expand beyond the SEK290bn of announced asset purchases but return to this size by end-2019.

Whether such an approach amounts to an extension of QE or not is something of a semantic question. The economic effect should be limited, given the size purchases involved are in any case small. But we think it would be a practical approach to managing the balance sheet and would help the Riksbank to start scaling back stimulus in a dovish way.

Stylised chart of the Riksbank's QE programme



Source: Riksbank and ING calculations

Author

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA
Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski
Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroeder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com