# Sweden's Riksbank to keep rates on hold but further cuts are coming

Higher-than-expected inflation and better growth figures mean Sweden's central bank is likely to keep rates on hold this month. We expect policymakers to signal two more cuts this year, but a stronger krona creates room for more. We expect three more cuts in 2024, but SEK's path remains mostly determined by external factors

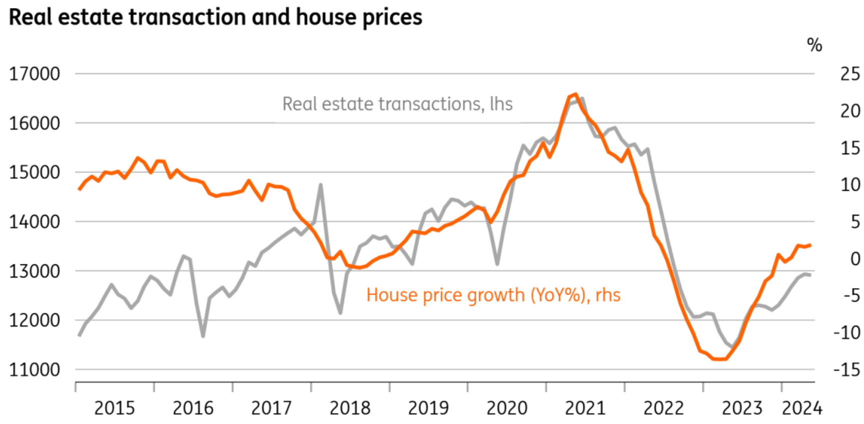

Having cut interest rates for the first time back in May, Sweden's Riksbank is widely expected to keep them on hold at the 27 June policy meeting. While policymakers signalled they would cut twice more this year, three weeks ago Governor Erik Thedeen said "we never exclude anything" but "the threshold is very high for a rate cut" in June.

## Disinflation has paused and the economy has stabilised

On the face of it, the data isn't pointing to any urgency to cut rates again in the short term. Core CPIF inflation rebounded from 2.9% to 3.0% in May, against consensus expectations for a decline to 2.6%.

Economic growth has been better too. Although the Swedish economy was in a technical recession during the second half of 2023, first quarter GDP came in much stronger than expected at 0.7%, compared to the Riksbank forecast of 0.0%. That's been coupled with a recovery in business and consumer confidence, as well as a noticeable pick-up in the purchasing managers indices (PMIs). And having been hit harder than elsewhere, the property market looks like it might have bottomed as well. The number of transactions is trending upward.

## The housing market is showing signs of life again




Source: Macrobond

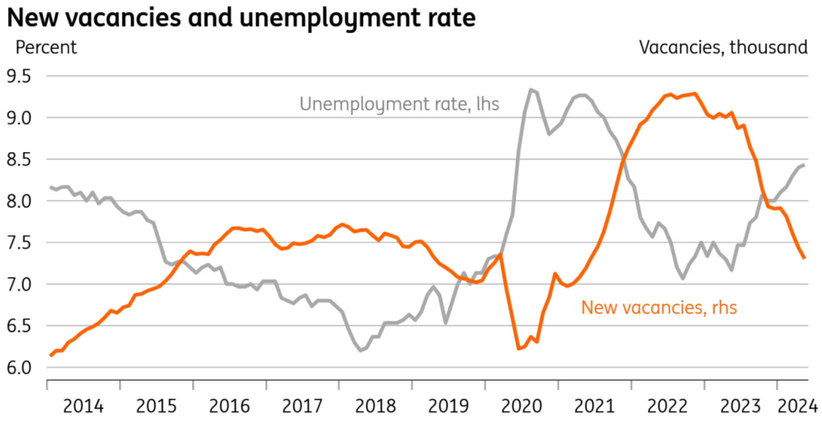
## Further rate cuts are coming

Still, we see four reasons to remain cautious on the Swedish outlook and therefore expect further rate cuts this year.

- First, the jobs market is continuing to weaken. Unemployment is up, new vacancies have continued to fall while the number of layoffs is above pre-Covid averages. The proportion of companies reporting that labour is a constraint on their business has fallen considerably, a trend we've not seen nearly as much elsewhere in Europe.
- Second, the first quarter bounce in GDP looks increasingly like it was a temporary jump. The most recent monthly GDP readings have been noticeably weaker.
- Third, the recent recovery in economic sentiment is, we suspect, strongly linked to the anticipation of rate cuts. The fact that corporate bankruptcies are nearly double the 20-year average is a stark reminder that the economy is much more interest rate sensitive than its peers. If a string of rate cuts ultimately aren't delivered, we suspect the potential for economic recovery later this year would quickly ebb away.

Finally, the Riksbank will be increasingly looking ahead to the round of wage negotiations next spring. The last settlement two years ago saw wage rises of 7.4% over the 24-month period. These wage talks matter because they set the tone for pay settlements across the economy. The Riksbank will take comfort in the fact that inflation expectations among both employer and employee organisations have fallen considerably from the peak, according to the highly regarded Prospera survey. The upside risks to overall inflation from the next wage-setting round therefore look relatively contained.

## The jobs market is continuing to weaken




Source: Macrobond

## Riksbank to reiterate May message

For now though, we expect the Riksbank to keep rates on hold at the June meeting, in line with consensus and market expectations. Only -5bp are factored into the SEK swap curve for June, but a cut in August and November is fully priced in.

We doubt that the Riksbank communication will change enough from May to trigger a major repricing in the curve. Disinflation has paused and growth is looking marginally better, but with CPIF almost at target and SEK around 3.5% stronger on a trade-weighted basis since the May meeting, we doubt the Riksbank will want to revise its pledge to two more cuts this year.

Expect, anyway, a generally cautious tone on disinflation and a reiteration that there are risks to the easing path stemming both from domestic factors (like a weakening of the krona) and external developments (geopolitics, other central banks).

Our call remains for three more cuts by the Riksbank this year as we see the European Central Bank cutting twice more and the Federal Reserve three times. The appreciation in the krona should allow more room for the Riksbank to cut as inflation continues to decline in Sweden.

## FX: Krona's risks mostly external in the short term

We doubt this Riksbank meeting will have a meaningful impact on the krona. As discussed, we think the communication will be broadly unchanged from the May meeting, by and large endorsing market rate expectations. If anything, the Riksbank may want to err on the side of caution given higher-than-expected inflation in Sweden and other parts of Europe, which means the balance of risks is slightly tilted to the upside next week for SEK.

That said, external factors remain overwhelmingly more important for the krona in the near term. The big SEK appreciation of the past month has been the consequence of lower US inflation data and a generalised good environment for high-beta currencies. The political events in the EU have put a lid on further SEK gains for now, although the currency has shown a somewhat surprising resilience. Indeed, the idiosyncratic EUR pressure from those political events means EUR/SEK should also be capped.

The major risks for the krona – and for the Riksbank's easing plan, by extension – still come from the US. Should US inflation fail to form a downward trend and at least endorse the current market pricing for two cuts by the Fed, EUR/SEK and USD/SEK can face substantial upside pressure. Still, this is not our base case, as we see US data leading to a Fed cut in September, followed by two more by year-end.

Our view on the Riksbank (three more cuts this year) is more dovish than market expectations and makes us believe EUR/SEK should struggle to keep the recent pace of depreciation. In particular, we think Norway's krone should outperform Sweden's krona on the back of policy divergence. Still, a supportive environment for high-beta currencies means that a test of the 11.00 level this summer is possible in EUR/SEK. Given risks related to the US elections in the fourth quarter, we target 11.10 as a year-end value.

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