

In case you missed it: Collision course with Brussels

Italy is defying the EU's demand to rein in debt, Brexit talks remain at an impasse and Swedish politics have settled into trench warfare. Where will it all end? Our analysts gaze into their crystal balls. Plus, a look at the diverging views on Fed policy in 2019 and a special report on the very strange attitudes to financial risk

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Italy: Politics trumps fiscal discipline

The Italian government's choice to mark a break in the fiscal adjustment path was partly expected, but the scope and, more importantly, the...



Source: Shutterstock

After days of noises, leaked numbers and what not, the Italian government approved but hasn't published, the framework for the next budget. This was the first official opportunity for the new Five Star Movement and Northern League's government to put their actual stance on budgetary policy and attitude towards Brussels.

No fiscal splurge but confirmation of piecemeal approach

The debate over the last month had already made clear that Italy wouldn't be in for a massive fiscal splurge. Top officials from both the League and 5SM had accepted the introduction of the three strongholds of the government programme, i.e. the introduction of a flat tax, the loosening of the Fornero pension reform and the introduction of a form of minimum universal income and pension would necessarily follow a piecemeal approach.

Still, uncertainty remains as to how challenging the proposal would be for the EU.

The planned 2.4% target confirms politics wins over fiscal discipline

Inevitably, all eyes were focused on the headline deficit target.

During the debate, the finance minister Giovanni Tria consistently played a reassuring role for markets, reiterating his drive to prioritise fiscal discipline, and particularly the need for a steady decline in the debt to GDP ratio. He quantified his view pointing to a possible 1.6% deficit/GDP target for 2019, which would allow the government to start implementing electoral promises while remaining consistent with a small decline in the structural deficit, deemed as the minimum acceptable outcome for the EU Commission.

However, the prominence of fiscal rigour wasn't shared by the two main stakeholders of the government alliance. Both Matteo Salvini and Luigi Di Maio converged on the idea that more fiscal leeway should be left to implement their electoral promises - and reportedly setting a 2.4% deficit/GDP target for the next three years.

A weakened Tria is likely to stay

Minister Tria, who was seen by the markets as an effective counterbalance to the deficit-inclined duo is now in a weakened position and was forced to bow yesterday.

However, we expect him to stay and play an important role in the making of the next budget, whose draft will be submitted to the EU Commission by 15 October and will enter its parliamentary passage on 20 October.

What will the EU Commission and rating agencies say?

Lacking projected fiscal and growth details, it's impossible to assess the extent to which the EU fiscal requirements will be missed under the planned deficit profile. In case of a big mismatch and continuous clash, we won't rule out the future re-opening of an excessive deficit procedure against Italy.

Also, the way the budget will be crafted can still have a say in the pending credit rating decisions expected from Moody's and S&P at the end of October. To be sure, after yesterday's deficit target announcement, the risk of a resurrection of medium-term debt sustainability concerns has now gone up, as has that of a possible downgrade. Markets are already showing their concern.

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Federal Reserve: Onwards and upwards

The Fed voted unanimously for another 25 basis point rate rise and while policy is no longer described as “accommodative” the “gradual...



Source: Shutterstock

A tweak in the language...

As almost universally expected the Federal Reserve has decided to raise the Fed funds target rate range another 25 basis points to 2-2.25%. The accompanying statement has dropped the sentence that described the Fed's monetary stance as “accommodative”, but hasn't replaced it with any other descriptors. However, the Fed continues to expect that “further gradual increases” in the policy rate will be required for them to achieve their growth, labour market and inflation mandate. There were no other changes to the text with activity and job gains still described as “strong” while inflation remains near target.

New Forecasts suggest upside risks

The Fed has updated its economic projections though, with an extra “dot” in the form of new Fed Vice Chair Richard Clarida. GDP growth expectations for 4Q18 have been upped to 3.1% from 2.8% in June while the 2019 forecast has been raised a tenth of a percentage point to 2.5%. The forecast range has been extended to 2021, which is expected to see growth of 1.8%, down from 2% in 2020. This 1.8% figure is in line with the Fed's longer-run growth expectation. These projections are broadly in line with our own forecasts.

Inflation forecasts have barely changed and point to ongoing outcomes close to 2%.

Unemployment projections are also broadly unchanged with 3.5% expected to be the low through 2019 and 2020.

As such the Fed continues to predict a central rate of 2.4% for end 2018 – implying one more rate rise this year. While 2019 is pencilled in at 3.1%, implying three rate rises and 2020 is at 3.4%. This appears to be the peak with the new 2021 prediction also 3.4%. However, the Fed has bucked the recent trend of cutting its longer-run projection and actually nudged it up to 3%.

ING's view

In terms of our view for Fed policy, economic activity is undoubtedly very strong with another 4%+ GDP growth figure looking possible for 3Q18, while all of the major inflation measures are at or above the Federal Reserve's 2% target. Wages are picking up, the unemployment rate is close to an 18-year low and asset prices continue to rise. These all point to further interest rate rises, with another 25 basis point rate hike looking probable for December – 12 of 16 Fed officials predict it in the "dot diagram".

However, the outlook is more clouded for 2019. A recent Bloomberg survey suggests that analysts are favouring a 25bp rate hike in each of the first three quarters of 2019, identical to the Fed's guidance within today's forecasts. The market, on the other hand, is only really pricing in one hike next year. We are in the middle favouring two – one in 1Q19 and one in 3Q19.

We see the US economy facing more headwinds as we move into 2019. The support from this year's massive fiscal stimulus will gradually fade while tighter financial conditions in the form of higher US borrowing costs and the stronger dollar will also act as a brake on growth. Then there is the gradual drag from trade tensions that will impact supply chains and put up the cost of doing business, while emerging market weakness could start to exert more of a drag on global and US activity. This should help to dampen inflation pressures in the medium term. The caveat is that if these external tensions ease then we would be willing to raise our forecast to three 25 basis point rate rises in 2019.

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Brexit blog: Why 'no deal' may still be avoided

Plus: What markets should look out for in this year's political party conferences, and is the UK economy heading into another rough patch?



Source: Shutterstock
Theresa May, UK Prime Minister

With six months to go until the UK leaves the EU, our weekly Brexit update/blog is back. Each week we'll try to give a brief digest of the twists and turns of the negotiations as the clock counts down, as well as provide our latest thoughts on the UK economy and markets.

Has the Salzburg meeting really raised the odds of no deal?

We kick-off following what has been, even by Brexit standards, a tumultuous period.

The big hope for the meeting in Salzburg last week was that at long last, EU leaders would signal talks were moving closer to a positive conclusion. But in the event, the week ended in bitter disagreement and stark warnings from both UK and EU leaders. So what went wrong?

Cast your mind back to July when the UK government reached a tentative (and ultimately short-lived) truce on what the future trading relationship should entail. The so-called Chequers plan,

which was effectively centred on single market access for goods, was met with a cold reception in Europe. But despite a range of concerns - chiefly on the issue of cherry-picking - EU negotiators had appeared wary to completely destroy May's plan publicly.

In fact, EU leaders had sounded decidedly more upbeat in their tone of language over recent weeks. With the UK political situation in a fragile state, Brussels appeared keen to tread carefully and if necessary, support the Prime Minister, Theresa May, where possible to boost the chances of parliament approving the final deal.

However, EU Council President Donald Tusk's warning last week that "the obvious truth" was the UK's Chequers plan would not work, signalled that the European side may be changing tack. Some reports indicate EU leaders were left frustrated by the hard-line May took in Salzburg, while others suggest Tusk's statement was designed to focus minds in London.

Either way, the question now is: does this latest impasse raise the risk of 'no deal'? Well, firstly it's worth remembering that there are actually two deals in play here. One of these will cover the future trading relationship, and for all the current disagreement on Chequers and other possible models, this is not what stands in the way of avoiding a cliff-edge Brexit next year. While both sides are hoping to agree a fairly vague political declaration on what a future trade deal might look like, full discussions were never going to start in earnest before March 2019.

Instead, the focus now is on getting the other deal, the withdrawal agreement (covering all the formalities of the UK's EU exit), wrapped up in time to avoid the UK leaving the EU unexpectedly on World Trade Organisation terms. This relies on reaching agreement on the so-called Irish Backstop, and it's clear both sides remain bitterly divided on this issue.

We still think it's likely a deal between the EU and UK is struck

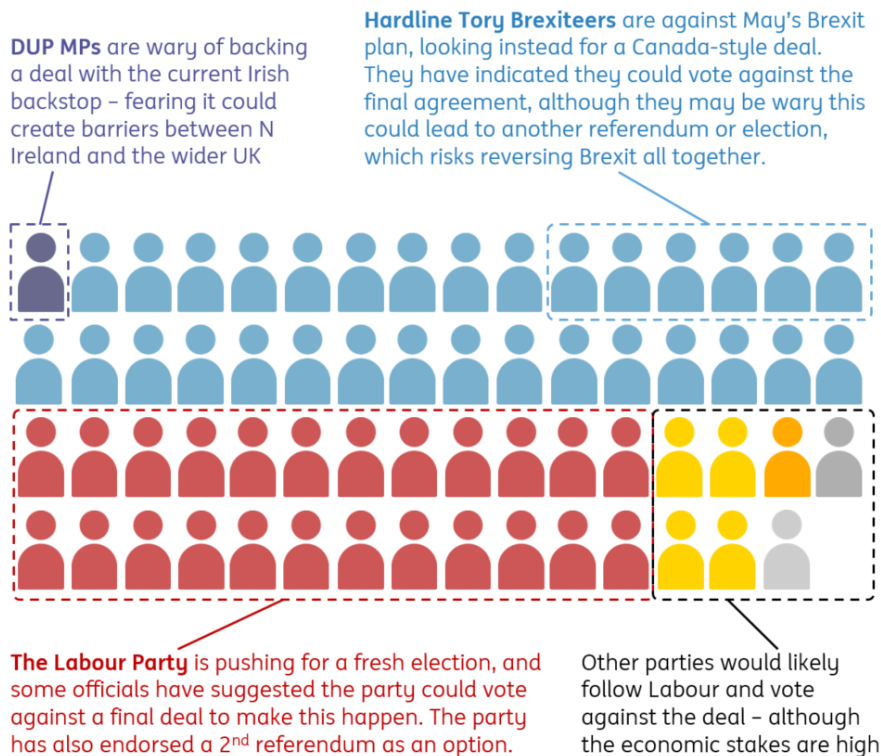
But remember too that May's tougher rhetoric comes just days ahead of the Conservative Party Conference, where she is already engaged in a very public battle with the more hard-line factions of her party on Brexit. Assuming the Prime Minister can survive the conference season, it looks likely she'll be more open to reaching a deal.

So despite the recent noise, we still think it's likely a deal between the EU and UK will be reached. But with no majority for any kind of Brexit in Parliament, the big challenge is going to be getting this withdrawal agreement approved by UK lawmakers, and one possible way the EU's Chequers dismissal could make life more awkward for May is on Ireland.

For all the flaws of the Chequers plan, it did arguably give the Prime Minister a political tool to convince MPs that, while the Irish backstop will be hard to swallow, it should never need to come into effect. The government believes the trade model it is proposing is sufficient to avoid a hard border within Ireland.

But with this plan now formally off the table in Brussels, May could face an even steeper uphill battle to convince MPs that the Irish backstop is a necessary compromise.

How different Brexit factions line up in Parliament



Source: ING

All eyes on Conservative Brexiteers as Labour reiterates it'll reject final deal

Away from the contentious border issue, there's also the big question of how the opposition Labour Party will vote.

Speaking at the party's annual conference, Shadow Brexit Secretary Keir Starmer made it pretty clear that Labour will reject any deal that PM May agrees with the EU. Of course, the main motivation for that is that it could force a general election. If that's not possible, Starmer said that the party would be open to a second referendum, possibly including the option of 'remain'.

Given the economic carnage that 'no deal' would likely induce, it's possible that not all Labour MPs will be so willing to reject the deal with the stakes so high. But with the likes of the Lib Dems and other smaller parties, as well possibly even the DUP, likely to follow the bulk of Labour MPs if they vote against the final agreement, the chances of 'no deal' may well hinge on what the Conservative Brexiteers decide to do.

This is set to be the key theme of next weekend's Party Conference and following the EU's Chequers rejection, there is immense pressure on PM May to take a harder stance and commit to something closer to a Canada-style free trade model. So far May has resisted this pressure, and talk of a leadership contest has failed to materialise over recent weeks. Assuming she can survive the conference season, the Prime Minister may be calculating that in the end, the Brexiteers within her party will approve the deal. Faced with the possible options of 'no deal', another election or a second referendum, the latter two of which could see Brexit cancelled altogether, there may be limited incentive for Conservative MPs to rebel against the government when push comes to

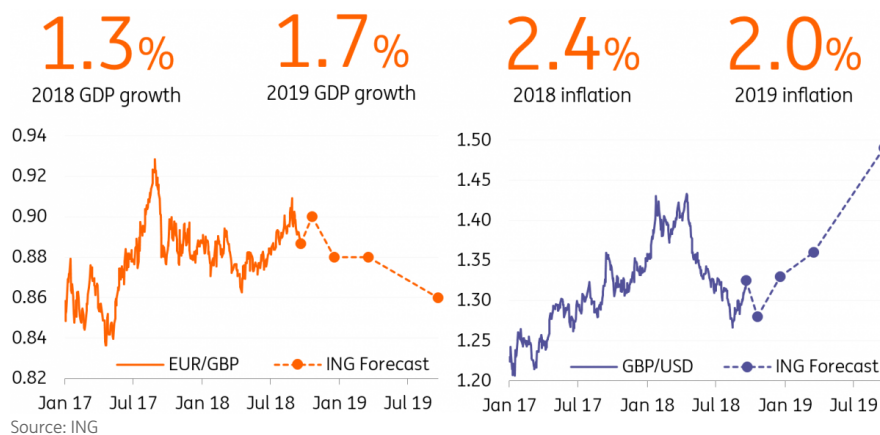
shove.

Of course, we're unlikely to know for sure until mid-late January at the earliest, and in the meantime, Brexiteers are likely to maintain maximum pressure on the government to make concessions before a deal is agreed. This says that Brexit talks are only likely to get noisier in the near-term.

Other things to watch this week

- It's a light week for UK data, but **keep an eye on consumer confidence on Friday**. Sentiment is already weak, but it will be interesting to see if consumers are becoming more concerned in light of recent 'no deal' warnings. One of the reasons why the UK economy hasn't fallen into recession since the Brexit vote is that employment has held up. But as the warnings about the practical, day-to-day risks get louder, there's a risk workers begin to get more anxious about job security and personal finances. We therefore think there's a risk the economy loses more momentum over the winter. Even now, confidence is flirting with multi-year lows, which is particularly stark when compared to the level of optimism in the US and elsewhere in Europe (even discounting the latest slip), both of which are near decade-plus highs.
- Having heard relatively little from Bank of England policymakers over recent weeks, **we'll hear from four speakers this week - including Governor Carney**. While it's always intriguing to see a sudden increase in Bank communication, we doubt policymakers will offer any fresh hints on rate hikes. Given the economic risks mentioned above, we think the Bank will find it tricky to lift rates again before Brexit, and we don't expect another rate rise before May 2019 at the earliest.

Key UK forecasts



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Swedish politics: Will it all be over by Christmas?

As Swedish politics settles into trench warfare, the key question is whether anyone can form a sustainable government. New elections early next year could...



Source: Shutterstock

Yesterday, Swedish Prime Minister Stefan Lofven lost a vote of confidence in parliament, putting an end to his four-year centre-left government and triggering the start of negotiations on forming a new one. Given, no natural coalition holds enough seats to form a government - a compromise of some kind will be necessary. But with most parties doubling down on a set of mutually incompatible restrictions on what kind of government they will accept, a solution looks some way away.

What happens now?

The newly elected speaker will start consultations with the eight parties. He will then give the party leader he judges has the best chance of successfully forming a government a mandate to propose a new government to parliament. If the proposal is voted down, the speaker will seek to give another party leader the chance. There can be up to four rounds of consultations and voting before new elections are called, which are likely take place in March next year.

A key date to watch is November 15th, the deadline for a new government to propose a budget for 2019

While the current budget can be rolled forward by parliament, it seems plausible to conclude that if a new government is formed by mid-November then new elections are likely. And if a compromise government is formed, the budget will be the key test of whether it can govern – failing to pass a budget likely means falling at the first hurdle.

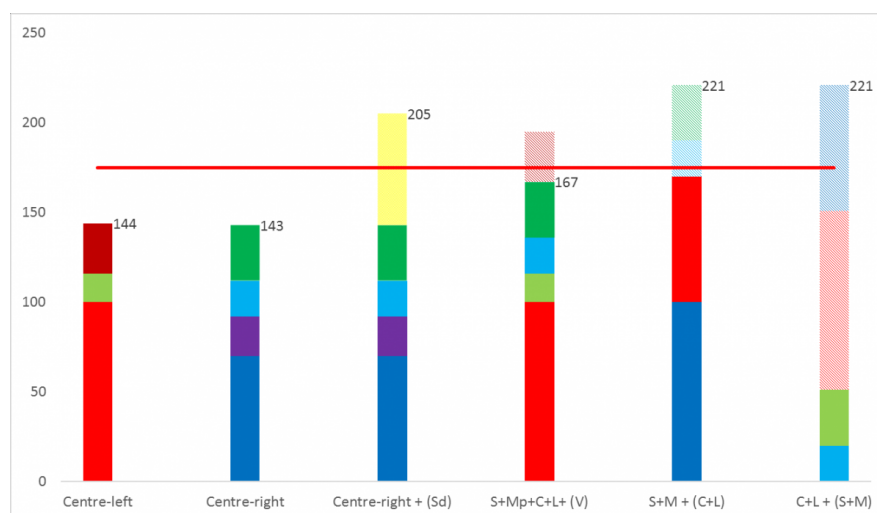
Forming a government is arguably easier in Sweden than most countries because it only requires a majority of parliament that doesn't vote against the proposed government (rather than a majority in favour). In practice, a government also needs to be able to pass a budget, which requires a plurality in favour – a somewhat higher bar, and this is what led to the government crisis in 2014 when the centre-left's budget failed to pass.

Stalemate result requires compromises

The current parliamentary situation resembles that of the past eight years. Neither the centre-right nor the centre-left coalitions hold a majority, giving the far-right Swedish Democrats a potentially influential role. But most of the mainstream parties have ruled out cooperating with the far-right. They also won't continue the arrangement agreed in 2014 that allowed the centre-left to govern on the basis that it was the larger of the two mainstream coalitions.

In fact, over the course of the election campaign and in weeks since, the main parties have set out a set of restrictions on who they will cooperate with to form a government which, taken together, imply that no government can take power without someone breaking their pre-election commitments.

Potential governing combinations



Source: ING

But none of the options look appealing

The fact that the new speaker is from the Conservative party might increase the chance that the Conservative leader Ulf Kristersson gets the first shot at forming a government. Having won the speakership for his party, thanks to votes from the Swedish Democrats (without giving anything in return), Kristersson could push for a similar solution to forming his government.

Still, the question boils down to what options might be tolerable for parties holding a majority of seats.

As we pointed out [before](#), that will depend on what position the two centrist parties (Centre and Liberals) take. If they accept a government supported by the far-right (either the M+C+L+Kd constellation that governed from 2006-2014 or a Conservative-Christian Democrat cabinet) or a Social Democrat-led government with support from the Green and Left parties, then that would settle the government issue. Given their clear preference for a centre-right government, the former looks more plausible, though it would require them to stomach some level of support from the far-right.

The other option, which is still seen as the fall-back, would be for the two largest parties to cooperate directly to govern from the middle. This could either be through a grand coalition between the Social Democrats and the Conservatives (the two have never been in government together aside from the 1939-45 period) or a minority centrist government (C and L) tolerated by the two larger parties (for which there are a couple of, short-lived, precedents). Neither are likely to prove particularly stable but could provide a stopgap solution that would at least postpone new elections.

But the economy will probably be okay for now

The economy can probably manage without a government for some time, as in other European countries with protracted government formation processes like Germany and Netherlands in 2017 and Spain in 2016. As we've said before, there are no urgent decisions that can't wait another six months if that's what the political system needs to get a clearer answer on who should govern.

If no government is formed and the budget simply rolls forward, that would make the fiscal stance for 2019 largely neutral. This would be marginally negative for near-term growth, as a new government is likely to propose some combination of higher spending and lower taxes given the current surplus in government finances. But the difference is likely to prove fairly minor, given stimulus would be constrained by Sweden's fiscal rule.

That said, the difficulty in forming a new government suggests that, whatever the shape of the next government, governing will prove difficult as well.

This is a medium-term concern, given that the Swedish model relies on continuous structural reforms to keep the economy as competitive as possible. And the acrimonious political climate over recent months at least raises the question how the system would respond to a major economic shock.

If there are new elections, we expect that in the near-term some of the political risk premium that appeared to be priced into the krona in August and early September would return, especially if polls indicated the far-right were increasing their share of the vote. Conversely, if a government is formed, it may provide a brief boost for the krona.

Article | 26 September 2018

Aluminium: Yet another extension for Rusal

LME aluminium continues to trade at depressed levels. This is despite expectations of yet another ex-China deficit in 2019, a buoyant alumina market, and...



Source: Shutterstock

Where do we stand with Rusal and sanctions?

In the aftermath of US sanctions on Rusal, LME aluminium surged to \$2,537/t- a level not seen since August 2011. However since then, the market has trended back down towards the \$2,000-2,100/t range, as the US Treasury provided a number of extensions to Rusal. The aluminium market has also been unable to escape the downward pressure across the base metals complex from an escalating trade war between the US and China. Deadline extensions from the US Treasury, including the latest, which gives Rusal and the US until 12 November to come to a deal (the previous deadline was 23 October), have given the market some comfort that the US is keen to come to an agreement. Based on media reports, Rusal also appears optimistic that a plan for Oleg Deripaska to reduce his controlling stake in EN+ and ultimately Rusal will be accepted.

Along with the extensions, the US has allowed existing Rusal clients to enter certain new supply agreements, as long as they are consistent with past behaviour. The move is aimed at maintaining the status quo, as the absence of supply agreements could force Rusal to curtail output, whilst buyers would be forced to look elsewhere for supply, in an already tight market. While the

clarification allows agreements to be negotiated, risks remain as to how new agreements will be worked out after 12 November if the US Treasury doesn't provide sanction relief. In that case, buyers might be exposed once again to supply risks.

We expect that the US and Rusal will come to a deal, and if this is the case, we could see some immediate downward pressure on the market. We believe this would provide a good buying opportunity for consumers, with the market outlook still remaining constructive, driven by expectations for yet another deficit year in 2019 and stronger alumina prices.

What happens if there is no deal?

Russia exported 3.2mt of aluminium in 2017 with nearly 31% (1mt) of it going to the US, followed by Japan (0.53mt), Turkey (0.52mt) and the Netherlands (0.23mt). Rusal exports contributed to nearly 12% of global aluminium trade, and without Rusal supply, the ex-China deficit would likely widen to somewhere in the region of 4.5-5.0mt.

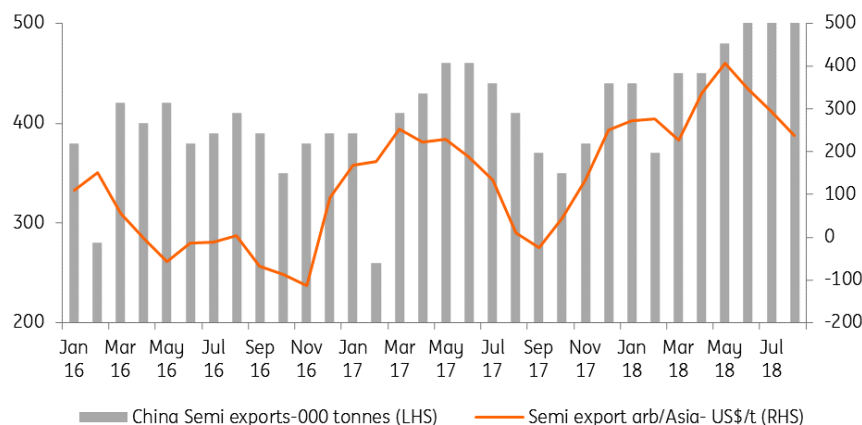
Rusal reported that its aluminium sales fell 12% year-on-year to 1.75mt over the 1H18. The majority of this decline occurred in 2Q18, with aluminium sales falling nearly 22% YoY, as buyers became increasingly cautious following the announcement of Rusal sanctions. Meanwhile the company's production was largely flat over 2Q18, resulting in the buildup of stocks. Rusal has already had to wind down some operations, announcing in August that it would shut production at the Nadvoitsy smelter, which has a capacity of 24ktpa but has recently been operating at about half this level. Whether we see further shutdowns will depend largely on the outcome of talks between Rusal and the US.

However, if we assume there is no deal, who can replace Rusal supply? One option is to draw down inventory, with estimates of off-exchange stocks outside of China in the region of 5mt, while inventories in the LME system stand at just under 1mt. But we would need to see a change in the shape of the forward curve. At the moment, it is largely in contango and so there remains an incentive for off-warrant holders to roll short hedges forward. We would need to see the curve move into backwardation (like we saw after the initial sanction announcement), in order to encourage off-warrant holders to liquidate their short hedges. The current shape of the curve, however, appears to confirm market expectations that there will be a positive outcome between Rusal and the US.

The other solution for the ex-China balance would be for the Chinese export arbitrage for primary metal to open up, which would allow the Chinese surplus to make its way onto the world market. This is easier said than done, with primary aluminium exports attracting a tax of 15%. Therefore we would need to see strength in LME prices, weakness in Chinese domestic prices, or a combination of the two. Chinese domestic prices, however, are unlikely to come under pressure in such a scenario. In order to see this, we would likely need to see Rusal material making its way into China at discounted levels, freeing up more Chinese material for the global market. However, before the potential for primary exports, we would likely see a pick-up in Chinese semi exports, with the export arb currently open.

While our current aluminium price forecast of \$2,350/t over 2H19 assumes a deal between Rusal and the US, failing to come to a deal would likely mean prices of closer to \$3,000/t.

Open Chinese semis export arb continues to support export flows



Source: Bloomberg, China Customs, ING Research

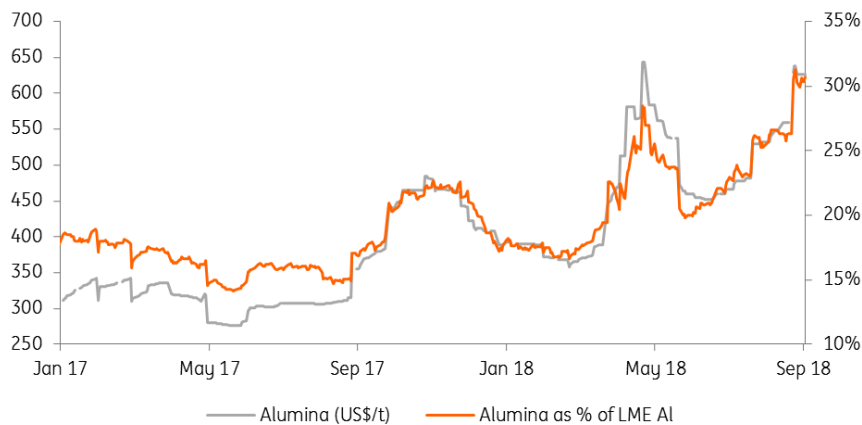
Alumina reinforces our bullish view

Stronger alumina prices should also be constructive for the aluminium market. Alumina prices traded back up towards nearly \$640/t in early September- a level last seen when Rusal sanctions were originally announced. The strength in alumina prices and the depressed aluminium market have meant that the price ratio of alumina to LME aluminium has broken 30% compared to historical levels of around 15-20%. A rallying alumina market, along with strengthening power prices, has clearly put pressure on smelter margins. Given the continued outlook for deficit we do not believe this is sustainable, and would need to see margins widen to more attractive levels for smelters.

The key drivers behind a stronger alumina market have been Norsk Hydro's Alunorte refinery operating at 50% of its 6.3mtpa capacity. There are also concerns over potential disruptions from Alcoa's operations in Australia due to a labour dispute, while uncertainty around Rusal also has implications, given the company's alumina operations; alumina sales from Rusal over 1H18 fell by 7% YoY to 953kt. The Alunorte disruption has gone on for longer than initially anticipated, but recently Brazil and Norsk Hydro signed cooperation agreements, including a Term of Adjusted Conduct (TAC) and a Term of Commitment (TC) to ease concerns on social and environmental action, which is expected to lead to the resumption of full production at site. For now, there is still no firm restart date but once Hydro receives the approval, it could still take a month to return to full production, according to the company.

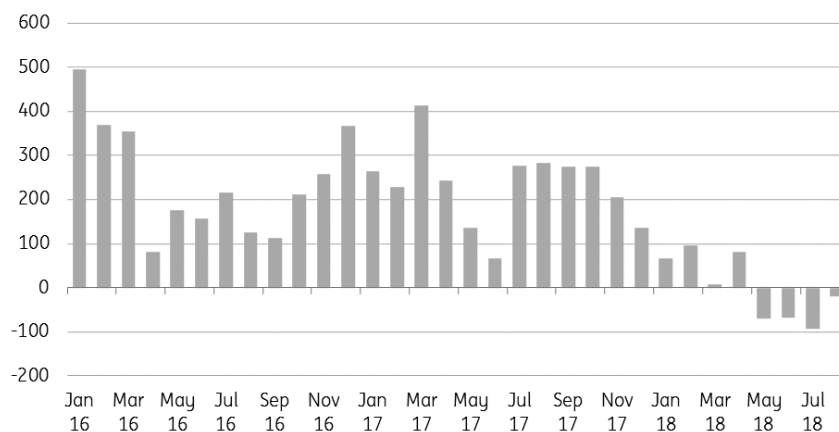
What has helped the ex-China alumina market to a certain extent has been the fall in Chinese imports. In fact, China has become a small net exporter of alumina to the world market. In the first eight months of 2018, China was a small net exporter of a little over 3kt, compared to a net importer of 1.9mt over the same period in 2017. However, this is unlikely to last, at least in the short term, given that the Chinese alumina market will likely tighten as a result of the upcoming winter cuts.

Alumina/LME aluminium price ratio breaks 30%



Source: Bloomberg, ING Research

China moves from a net importer to net exporter of alumina (000 tonnes)



Source: China Customs, ING Research

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New Riksbank call: Earlier hike likely, but dovish bias remains

After the September meeting and recent communication from policy-makers, we revise our view of Riksbank policy and think they are more likely to hike...



The September meeting marked a turning point in the Riksbank's policy stance. Policy-makers appear to have returned from their summer holidays in a rather sunnier mood, and now seem more determined to raise interest rates within the next six months. While further delays can't be excluded, we think they're likely to follow through this time, even if the Swedish economy continues to slow down and underlying inflation remains soft.

A firmer tone from the doves

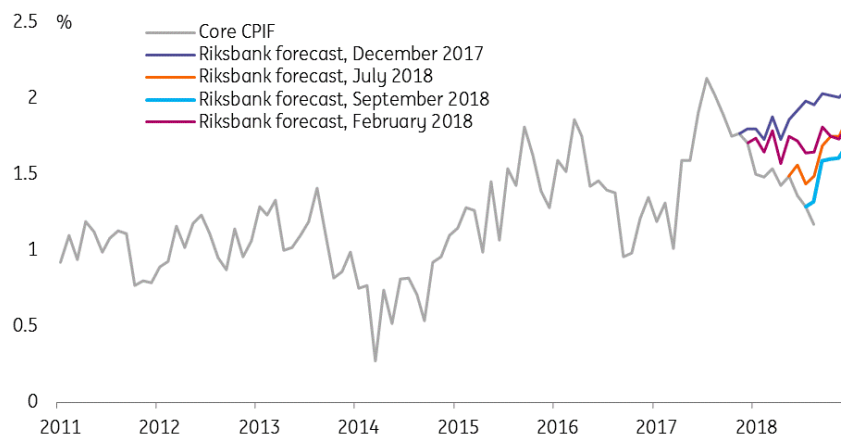
While the interest rate forecast published in September was revised down slightly to remove the potential for a hike in October, the policy statement explicitly indicates a 25bps hike in December or February. This is the first time in the current cycle the Riksbank has mentioned hiking rates at specific meetings, which suggests a stronger commitment to deliver on this forecast.

The minutes published last week and recent speeches from Governor Stefan Ingves, Deputy

Governor Kerstin af Jochnick, and Deputy Governor Per Jansson also suggest a shift in stance. From the minutes, it seems clear that by December three members - Henry Ohlsson, Martin Floden, and Cecilia Skingsley are likely to be voting for higher interest rates. But more importantly, the dovish majority (Ingves, Af Jochnick, and Jansson) all signalled clearly that they expect to increase the policy rate by February, and have reinforced that message over the past week.

Earlier in the year, the three dovish members appeared hyper-sensitive to repeated downside surprises in core inflation (seven out of eight inflation figures have been below the Riksbank's forecast this year). But despite this pattern continuing over the summer, all three now appear more optimistic about the outlook for inflation. Even ultra-dovish Jansson appeared content that inflation is likely to stabilise around the target and that rates can now rise.

The Riksbank's core inflation forecast has been consistently over-optimistic



Source: Riksbank

Suggests a revised reaction function

We interpret this new stance as meaning that further moderate undershooting of the forecasts would not be enough to delay interest rate rises further and that so long as the economy evolves broadly in line with the current forecast, the Riksbank is likely to follow through. This is also what Ingves and Af Jochnick implied in comments to the press, where they downplayed the GDP downgrade and suggested small misses in inflation forecasts were no big deal.

Soft inflation and growth data (we expect growth and inflation over the autumn to continue to come in a bit below the Riksbank's forecast) will probably shift the balance of the committee towards February rather than December. But we now believe it would take a more material change in the outlook - something like a sharp slowdown in Sweden (perhaps driven by the weakening housing market) or a worsening of the global environment (whether from the US-China trade war, Italy's fiscal situation, or emerging market woes) - to push the rate hike further out.

That means an earlier hike, but still a slow pace of tightening

This has forced us to revise our view of the likely path of Riksbank policy. We now see a 25bps hike in either December or February as likely, with December the less likely option. A further delay into April or even later is still possible if there is a material worsening of the outlook in Sweden or

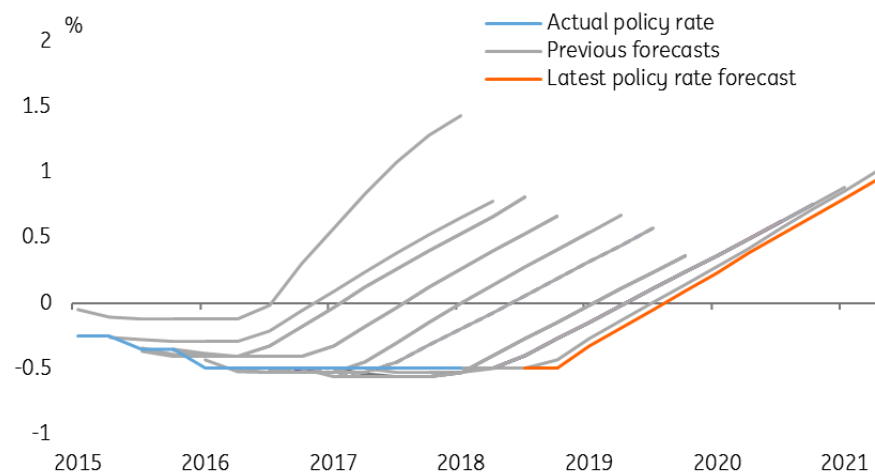
abroad, but this is not our central expectation.

That said, we don't believe the Riksbank has changed its outlook dramatically. It remains one of the most dovish central banks out there and will continue to approach policy tightening with extreme caution. That is why we think a hike in February is more likely than December, and still see some chance of another delay into mid-2019.

We also expect the Riksbank will seek to soften the first hike by combining it with a lower rate path (as Norges Bank did this week). This will most likely reduce the total tightening signalled by end 2019 from the current three hikes to two, with another two pencilled in for 2020.

Another possibility is announcing that reinvestments of QE purchases will continue beyond the current end-date in mid-2019. An announcement on future reinvestment policy is due by the April 2019 meeting but could be made earlier. Though the impact of reinvestments is marginal, extending them would nevertheless reinforce the Riksbank's dovish bias.

Riksbank interest forecasts. is this time different?



And risks remain to the downside

The risks to this profile are skewed downwards, given the Riksbank's bias and the potential for their forecast to (again) prove overly optimistic.

The key factor for us is the asymmetric reaction function that we attribute to Governor Ingves and the doves: they are happy to tolerate – and may even welcome – inflation modestly overshooting the 2% target, but believe inflation below target as risking a relapse towards weakened inflation expectations. Similarly, they still worry about a rapid appreciation of the krona, and would likely respond to sustained SEK strength, but have been very relaxed about the ~10% depreciation over the past year.

Also, the Riksbank will factor in high household indebtedness and the economy's consequent exposure to rising interest rates. Swedes are deeper in debt than ever before, and because most mortgages are floating rate or short-term fixed rate the pass-through to consumer demand will likely be fairly direct. This means households are more sensitive to higher interest rates than in previous cycles, and raising interest rates too fast risks damaging household demand. This will be a

constraint on the Riksbank for the foreseeable future, and in our view means that the Riksbank is unlikely to tighten faster than two hikes per year.

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Higher risk, lower reward? Attitudes to financial risk are seriously skewed

Most people are risk-averse and many have the counterintuitive belief that the more risk you take on, the lower the returns will be. These findings from...



falling stocks

People's perception of financial risk varies noticeably both between individuals within a country and between individuals from different countries. These risk preferences play a crucial role in understanding households financial behaviour and decision making. In a [recent article published on the VoxEU policy portal](#), I show the surprising extent of the differences in financial risk attitudes both within and between countries, the importance of behavioural factors in explaining these differences, and the challenges these present to standard investment theory and financial advice.

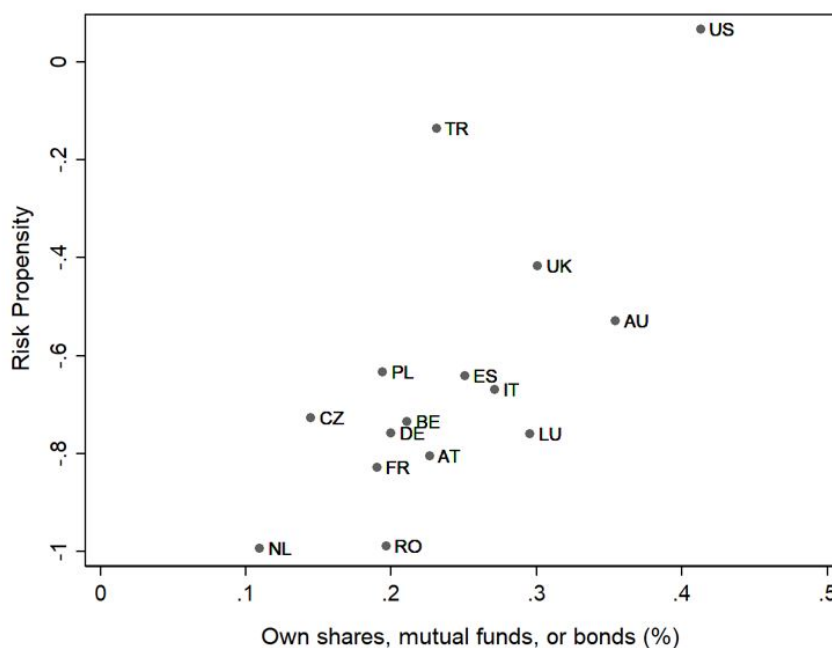
Risk avoidance

That people generally prefer to avoid risks when it comes to money should not surprise. However, the extent of that risk avoidance could be much higher than many realise.

Using individual responses collected in 2016 from approximately 15,000 people in 15 countries through the [ING International Survey on Savings](#), I provide several graphical insights into the willingness of households to take risky investment decisions and their attitudes to financial risk. In

general, I find that people seek to avoid risk. In 11 of the 15 countries studied, a large majority of the population prefers not to take financial risks.

This risk aversion is one of the most important characteristics that explains why households do not hold or have very low investments in risky assets such as shares, bonds and mutual funds. People prefer to keep their cash in checking or savings accounts instead, if they have the opportunity to do so. This is especially clear in the case of people living in the Netherlands, France, Germany, the Czech Republic and Romania. A more even spread between risk avoidance and risk-taking is seen in responses by people from the US, Turkey, Australia and the UK. While people in these countries still avoid risk in general, there are more risk takers.



Risk and reward?

What is more fascinating is the wide variation in the assessment of the trade-off between financial risk and financial reward between people in different countries.

People in the Netherlands, Austria and Germany think that investments in shares, mutual funds and bonds are much riskier than, for example, people in the US, Turkey, Australia and the UK. But at the same time, they expect the returns on these assets to be very low. This is consistent with the finding of a very skewed attitude towards more risk avoidance in these countries but it challenges one of the fundamental principles of investing. One of the first things people are told when investing is that higher financial returns require taking greater risk. This does not seem to be recognised by some. Many people living in, for example, Germany, Austria and Poland seem to have the counter-intuitive belief that the riskier the investment, the lower the expected rewards will be.

Behavioural matters

The results from this study show that people who indicated greater risk acceptance were also more likely to actually own shares, bonds or mutual funds. However, our analysis suggests that this

indication to accept risk is ten times more powerful in explaining whether a person would own risky assets than other objective factors such as the market returns on and volatility of these assets over the past one, five or ten years. This suggests that cultural and subjective dimensions may be much more important than macroeconomic and return factors in explaining people's financial behaviour.

Challenging norms

To be more relevant to the everyday lives of people, the finance industry needs to take a more comprehensive approach to understanding households' true and complete risk profiles.

Risk avoidance by households is not necessarily a good thing. Taking too little risk may mean life goals, such as a financially secure retirement or being able to pay part of children's tuition fees may not be possible. Understanding the reasons for risk avoidance can help avoid these situations in line with personal preferences. Further, these reasons are likely to be different from one country to the next. A one-size-fits-all approach to financial advice is definitely not recommended.

Read more about this here:

<https://voxeu.org/article/cross-country-differences-risk-attitudes-towards-financial-investment>

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