

Cautious Riksbank unlikely to halt krona's strength in 2021

Despite a more resilient end to 2020, Sweden's Riksbank remains cautious about the outlook. A further extension to the quantitative easing programme is possible later in the year, particularly if the downside risks surrounding the virus materialise - though a return to negative rates remains unlikely



Riksbank starts the year cautiously, despite more resilient 2020 data

The Swedish Riksbank has framed its first meeting of the year with a cautious tone. Sure, the end of 2020 was more resilient than expected given the rising number of restrictions - something that's reflected in an upward revision to the near-term level of GDP. And while the shallow nature of Sweden's economic hit means it will only be a matter of months before activity returns to pre-virus levels, the Riksbank doesn't expect core inflation to get sustainably closer to the 2% target until 2023.

It comes as no surprise therefore that the central bank has continued to signal a flat path for the repo rate out to 2024. But what about QE? The Riksbank expanded its bond buying envelope last

November, giving it scope to continue purchases throughout this year. At this meeting, the central bank has indicated it will front-load more of the remaining chunk of the SEK700bn package during the first half of the year.

That implies some tapering later in 2021, though a further expansion of this programme is entirely possible, particularly if the downside risks surrounding the vaccination and virus story materialise. However, we continue to doubt that policymakers will take the repo rate back into negative territory again - the fact that the central bank resisted this at the peak of the pandemic last spring suggests the bar for a rate cut is set pretty high.

SEK: Not overly dovish but not strong enough to push EUR/SEK below 10.00

With the central bank striking a balancing act between a somewhat improved economic outlook, and inherent caution, the knee-jerk reaction saw the krona strengthen as some market participants had been entertaining the idea of more asset purchases, particularly after the Riksbank's dovish surprise at its November meeting.

While modestly surprising the market, the bias coming from the meeting today is not enough, on its own, to push EUR/SEK below the 10.00 level. For this to happen, we need to see the 2Q economic recovery in the eurozone and Sweden, which will then benefit cyclical currencies such as SEK. Near-term, we expect EUR/SEK to continue hovering around the 10.10 gravity line, with the next leg of SEK strength likely coming in 2Q, rather than in coming days.

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