Lower Swedish inflation creates headache for Riksbank

January's shock inflation figures come at an awkward time for policymakers, who only a few weeks ago opted to raise interest rates. But despite the fairly muted outlook for inflation, we aren't convinced rates will move again in either direction any time soon

Shoppers in Stockholm

Disappointing CPIF figures

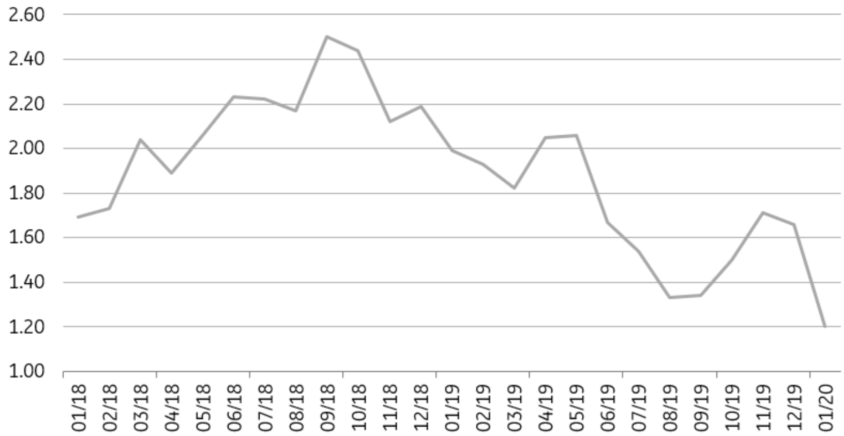
Swedish inflation came in much lower than expected in January, which comes just a month on from the Riksbank's repo rate hike at the end of 2019. Headline CPIF fell from 1.7% to 1.2%, noticeably below the Riksbank's latest 1.5% projection. This is partly down to warmer weather lowering electricity prices, but there was also an unexpected drag from communication costs, which seems to be down to lower telecom equipment prices. There was also a small downward impact from the annual changes to the inflation basket.

1.2% Jan CPIF

Lower than expected

This is undoubtedly a headache for the Riksbank, but we'd caution against assuming that policymakers will think about lowering rates again in the near-term. Policymakers have signalled a weariness about negative interest rates becoming a permanent state of affairs, while they had already pencilled in a decline in CPIF over the next few months (albeit not quite this quickly).

Sweden CPIF (YoY%)



Source: ING, Bloomberg

Expect the focus to quickly shift to wages negotiations

The Riksbank's focus will also be more squarely focused on the centralised wage negotiations due to be wrapped up in the spring. These will affect around 2.8 million workers. Policymakers remain cautiously upbeat on the rate of pay growth over the next few years, partly because it projects robust productivity growth in 2021/22.

But the risk is that the wage negotiations don't result in a material improvement relative to the 2017 round. The jobs market appears to be deteriorating, although admittedly the official unemployment numbers are still pretty volatile. Inflation expectations among both employee and employer organisations have also become more muted.

Riksbank unlikely to change rates anytime soon

All of this emphasises that December's repo rate hike is unlikely to repeated. We suspect it would require a fundamental and prolonged revival in global growth for policymakers to start thinking about resuming their tightening cycle again. The risks presented by the 2019 Covid-19 outbreak mean the recent levelling-off we've seen in economic sentiment may not translate into anything more just yet. The bottom line is that interest rates are unlikely to move in either direction any time soon.

For FX markets, the disappointing inflation outlook should ensure that the Swedish krona will continue to offer the lowest yield among its G10 cyclical peers, making it unattractive to own during periods of rebounding risk appetite. If anything, SEK remains an attractive funding currency in the relative value space.

Author

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

Disclaimer