

## Riksbank signals pause; coronavirus biggest near-term risk

Coronavirus is probably the key near-term risk for the relatively open Swedish economy. But barring a material deterioration in the growth outlook, the latest Riksbank meeting emphasises that rates are unlikely to move in either direction any time soon



Having hiked the repo rate out of negative territory back in December, the Riksbank has kept rates on hold at its first meeting of 2020 and has signalled a prolonged pause. Like the last, its new rate projection has rates on hold until 2023.

That's not to say there aren't risks, and the most obvious one stems from coronavirus. Policymakers were a little more vocal in their latest report than their central bank counterparts overseas, noting that further global contagion could have "serious consequences in Europe and the United States". As an open economy, Sweden is particularly vulnerable to supply chain disruption (lack of intermediate parts from China) and lower demand from Asia.

The inflation outlook also appears fairly lacklustre. Predictably, the Riksbank lowered its 2020 CPIF forecast based on lower energy prices. But the bigger risk in our opinion stems from wages. Policymakers are forecasting a general uptick in the rate of pay growth over the next few years.

However, as the key wage negotiation processes which will set the pace for pay growth over the next few years reach their climax, it's likely we won't see a significantly higher outcome. The jobs market is showing signs of turning, while inflation expectations have moderated.

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Having said all of that, the chances of a rate cut in the near-term seem fairly low. Barring a material worsening in the outlook, we think policymakers will be wary of taking the repo rate into negative again so soon after raising it. Don't forget too that policymakers are less wary about the risk of currency appreciation than they were a few years ago, and are in fact looking for some modest SEK strength in their latest numbers.

The bottom line is that rates are unlikely to move in either direction any time soon.

## **SEK: Nothing to be cheerful about**

As expected, the February Riksbank meeting was a non-event for SEK. The projected long-term stability of interest rates (with a possible renewed easing should the economic prospects deteriorate) continues to make SEK an unattractive currency. That's particularly true against NOK, where recent upside inflation surprises suggest the possibility of a rate hike later this year can't be ruled out, although this isn't our base case.

With Sweden being a small open economy, meaning that the coronavirus-induced downside risks to global trade and growth are negative for the krona, and with SEK exerting the second most negative real rate in the G10 FX space after the euro, there are few reasons to be cheerful about the currency.

Should global sentiment stabilise, we expect SEK to lag the gains of its cyclical G10 currency peers as (a) SEK retains the lowest real and nominal rate within this per group and (b) is to benefit the least from the subsequent rebound in commodity prices.

We see SEK upside vs the euro as limited and look for the EUR/SEK to trade around the 10.60 level in coming quarters.

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