

Sweden's Riksbank cements dovish stance with no rate hikes forecast

Despite some excitement around recent inflation data, Sweden's central bank has again signalled it doesn't intend to hike the repo rate in the next three years. With the krona's rate profile likely to remain unattractive in the medium-term, we expect it to lag pro-cyclicals backed by domestic tightening cycles in periods of supportive risk sentiment

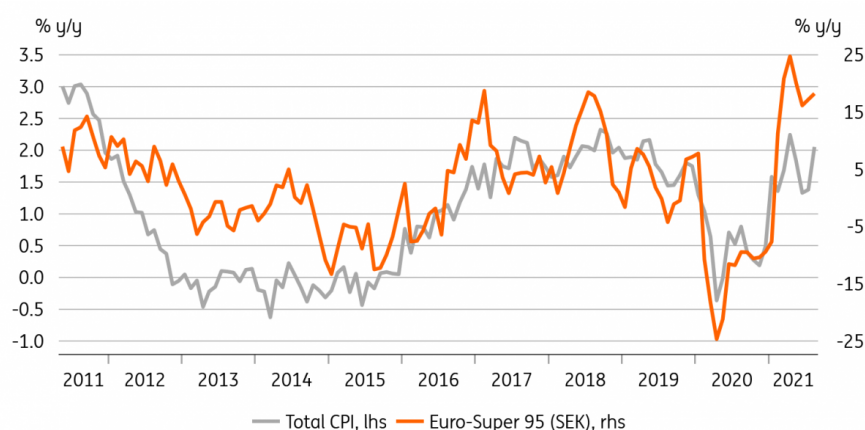


Source: Shutterstock

At a time when global central banks are inching towards reducing the level of stimulus, the Swedish Riksbank remains firmly at the back of the pack when it comes to tightening policy. Policymakers unsurprisingly kept the repo rate on hold this month, although a surprise burst in inflation during August had raised the possibility that the central bank could introduce some hikes into its published interest rate projection.

In reality, any changes to this profile were only ever likely be small and focused on 2024 at the earliest, given that the rise in inflation can be largely explained by energy, food and like everywhere else, supply chain disruptions. But in the event, the Riksbank opted against signalling any rate hikes at all. The result is that the central bank is forecasting no changes in its repo rate for at least the next three years.

Energy costs have helped lift Swedish inflation



Source: Macrobond

Whether or not that changes will inevitably boil down to wages. Here, the Riksbank is modestly optimistic, noting some recent acceleration in pay growth. Sweden is facing a jobs mismatch, which is no doubt putting pressure on wages in some areas. But ultimately the direction of pay settlements is largely determined by multi-year negotiations, the next of which won't come until 2023. Hikes in the repo rate will rely on these resulting in rate of wage growth noticeably above 2%, which was the product of talks held in 2020. For now, it's worth noting that inflation expectations over the medium-term - a key aspect of any negotiations - are reasonably stable.

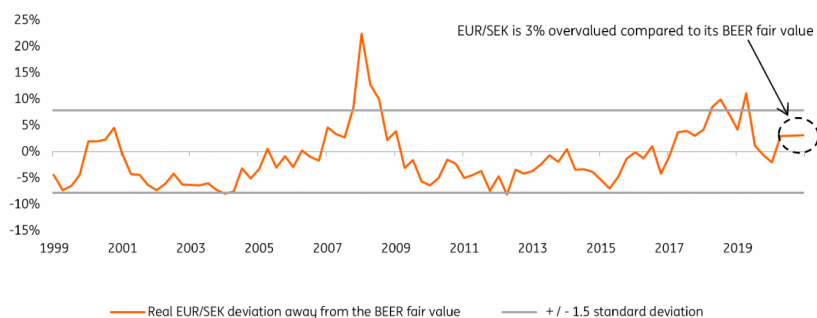
The more pressing question is what will happen to the central bank's bond holdings accumulated under the recent QE programme - in particular covered, or mortgage bonds. The Riksbank will complete its planned balance sheet expansion later this year and has committed to maintaining the size of these bond holdings through 2022 - albeit there'll be some volatility due to the irregular and sizable nature of maturities.

In all likelihood, the central bank will stop (or reduce) reinvestments of some maturing bonds from 2023, which will act as an initial form of policy tightening.

SEK: Rate profile to remain unattractive

SEK's reaction to the Riksbank rate announcement was very muted, likely indicating markets have remained quite reluctant to price in any hawkish turn just yet. From a forward-looking perspective, the reiteration of the Riksbank's dovish policy continues to cloud the outlook for SEK, as any periods of sustained recovery in risk sentiment should - in our view - see the krona lag other procyclical currencies (like Norway's krone) which can count on a domestic tightening story.

That said, SEK's medium-term outlook remains tied to the prospects of the global and, in particular, European recovery. For now, we are still inclined to think that countries with high vaccination rates - like the European ones - will be able to weather the coldest months without having to resort to strict containment measures, as third doses of the vaccine are rolled out. We think such prospects leave room for EUR/SEK - which is around 3% overvalued, according to our medium-term BEER fair value model (chart below) - to gently trend lower into the middle of next year, moving sustainably below 10.00 in 1Q22.



Source: ING, Refinitiv

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.