

Riksbank's half-hawkish hike leaves the krona vulnerable

Sweden's Riksbank has raised rates and signalled a 40% chance of another hike, which we think could be delivered if we get renewed SEK weakness or renewed upside surprises on inflation. Our base case is no more hikes. SEK dodged a drop thanks to the reserve hedging announcement, but lack of hawkish conviction leaves it vulnerable



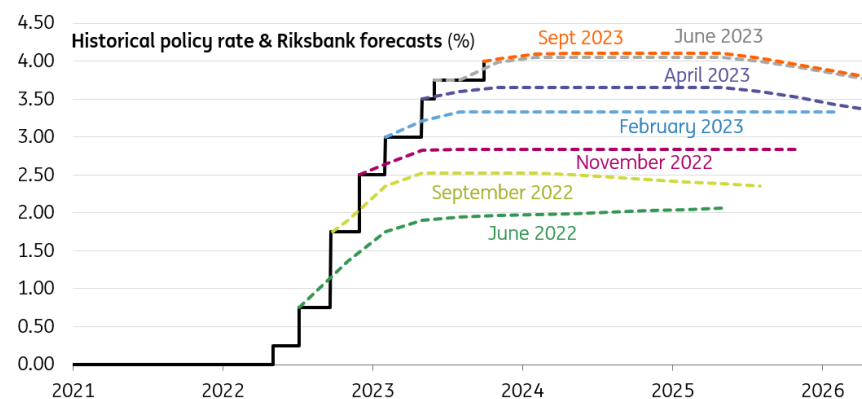
Sweden's Riksbank may have just hiked rates for the final time – although it isn't keen not to say so explicitly. Formally, the latest statement and new projections flag a 40% chance that rates could rise again by early next year. But with both the Federal Reserve and European Central Bank likely having concluded their own tightening cycles already, we think the Riksbank can probably get away with a pause at the next meeting in November.

It's a close call though, more so than with other central banks. The latest 25 basis point hike in the policy rate reflects the reality that the trade-weighted value of the krona is back to its lows and services inflation is still far too high, having shown minimal progress over the summer months. Further currency weakness or renewed upside surprises to inflation could conceivably unlock one final hike later this year.

But the economy is clearly vulnerable too. Admittedly, there have been some signs of stability in the housing market after a 16% peak-to-trough fall in prices, and consumer confidence has been rebounding. The jobs market is also looking surprisingly resilient. Ultimately, Sweden remains among the most exposed in the short term to higher interest rates, given a large chunk of mortgage lending is done at floating rates. We expect further weakness in housing and some clearer signs of deterioration in the official manufacturing numbers too.

That means the trade-off facing the Riksbank between bolstering the currency and avoiding a deeper economic downturn is increasing. And that's why our base case for November is currently a pause.

Riksbank interest rate projections over time



Source: Riksbank

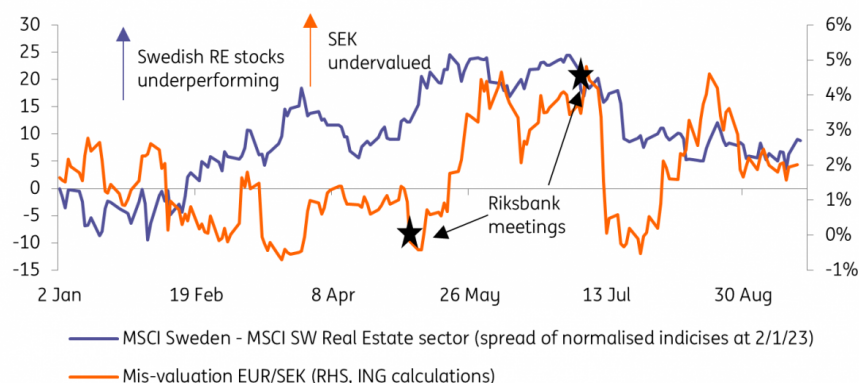
Riksbank opting for 'mark-to-market': a missed chance to boost SEK

In the run-up to the Riksbank meeting, we had been stressing that the Bank had to focus almost solely on sounding hawkish if supporting the krona was the real priority. It is clear that the krona's weakness remains very central, although we see today's announcement as a missed opportunity to provide sustainable support to SEK.

Markets were pricing close to a 50% implied probability of another 25bp move before the meeting, and the Riksbank seemed to opt for some 'mark-to-market' rather than exceeding investors' expectations. Ultimately, that had an initial negative impact on SEK, which was then offset by the announcement that FX reserve hedging would start already in September (more below).

As shown below, the Riksbank had managed to keep the risk premium on EUR/SEK compressed despite mounting domestic real estate distress before the April meeting. That was possible by keeping a resolutely hawkish attitude, even at the risk of promising more than what could be delivered.

The Riksbank could control EUR/SEK risk premium



Source: ING, Refinitiv

FX hedging announced: This is not FX intervention

We had examined the reasoning behind heading FX reserves [in this June article](#), when the Riksbank had initially discussed the measure. Today, the Riksbank announced it will sell USD 8bn and EUR 2bn for SEK in the next four to six months, with the aim of limiting the Bank's losses if the krona appreciates. It was reiterated that it does not have a monetary policy purpose, although many have been pointing to this measure as a de-facto covert FX intervention.

We read it more at face value as a financial stability purpose, and the way this has been pre-announced and then detailed today seems to confirm that. It's clear the Riksbank will welcome the beneficial effects on the battered krona, but if this announcement was really aimed at turning the tide for the krona (effectively FX intervention), it was set to be a failure from the onset. Markets had already positioned for the announcement (but the amount was a bit higher), and adding another hike to the rate path would have likely had a much more sustainable and sizeable impact on SEK.

We think today's reserve hedging announcement has two benefits for SEK: it sent a signal that the Riksbank is really expecting a SEK appreciation (and is ready to put some money behind this view) and that action in the relatively illiquid FX forward and swap market during autumn means the pace of a SEK recovery can be faster.

EUR/SEK: 12.00+ risk remains on the table in the short term

However, we want to stress this was a missed chance for the Riksbank to materially lift SEK. The new rate forecasts suggest another hike is not particularly likely, but markets still see good chances of that being delivered. Once again, EUR/SEK is left to be driven by external factors, at least until key Swedish data are released.

This isn't great news for SEK in the near term. Another jump to 12.00 is absolutely possible, and breaking above that level is also a very tangible risk given global risk instability and Swedish data volatility. We agree with the Riksbank that the shockingly undervalued krona will ultimately appreciate and that hedging FX reserves is a good idea. We still think that our 11.00 EUR/SEK target for the second half of next year can be reached. However, the Riksbank missed another opportunity to insulate SEK from more short-term pain.

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