

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



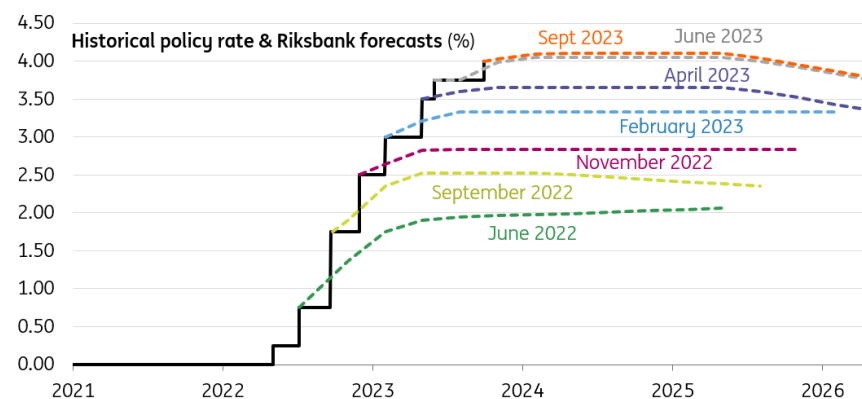
Sweden's Riksbank may have just hiked rates for the final time – although it isn't keen not to say so explicitly. Formally, the latest statement and new projections flag a 40% chance that rates could rise again by early next year. But with both the Federal Reserve and European Central Bank likely having 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

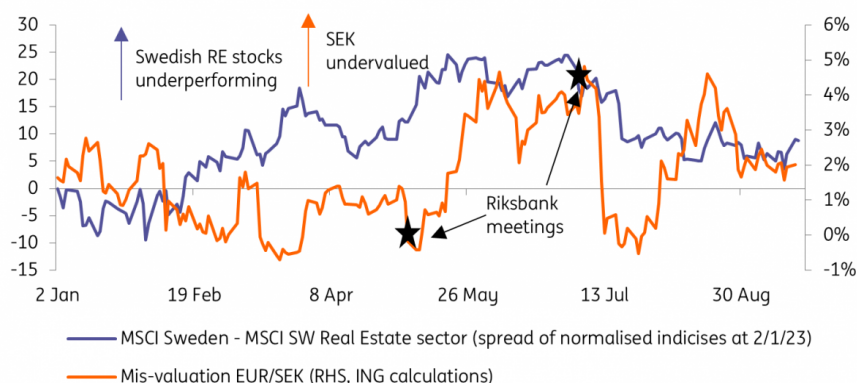
Riksbank opting for 'mark-to-market': a missed chance to boost SEK

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.

Authors

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 <http://www.ing.com>.