

Sweden's Riksbank stays cautious, for now

Sweden's central bank has defied hawkish expectations and is sticking to its past script of no rate hike before 2024 and no change to its balance sheet size in 2022. In practice, both policies are likely to be adjusted earlier than the Riksbank is currently signaling, but with a lot of tightening already in the price, the medium-term upside for SEK is limited



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Set against the increasingly hawkish Federal Reserve, the European Central Bank and Bank of England, Thursday's Riksbank meeting erred more on the dovish side than we had expected.

While recent ECB rhetoric increasingly points to a deposit rate hike within the next 12 months, the Riksbank is still formally signaling no change in the repo rate until the latter part of 2024. The bank's closely-watched interest rate projection has only altered subtly in its latest update compared with November.

In practice, we think the first rate hike is likely to come much earlier than that, potentially in the

first half of 2023. Wage negotiations, which occur on a three-year cycle, are due to conclude next spring and there's a growing chance that these will result in a higher outcome than the 2020 round. The jobs market is tight while inflation expectations among employer and employee organisations are gently increasing.

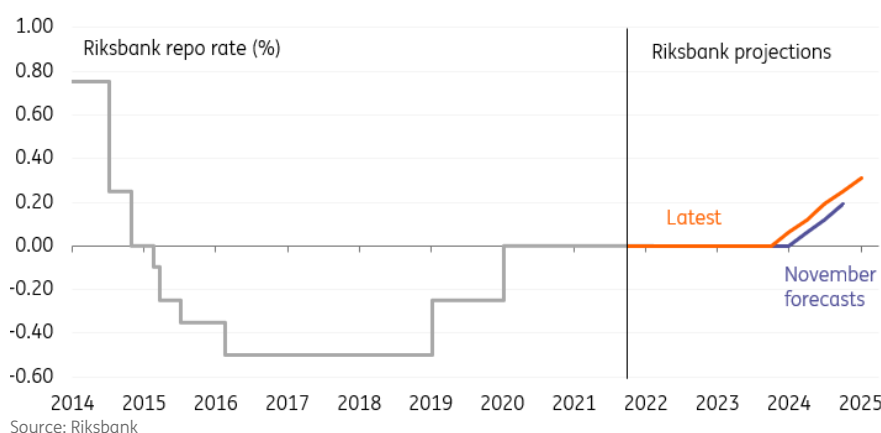
Admittedly, policymakers were never going to acknowledge such a marked shift in rate hike plans at this stage, but we had suspected they might hint for the first time at a rate rise next year.

The other slight surprise is that the Riksbank has opted against shrinking the size of its balance sheet this year. It has become increasingly clear from recent meetings that the Swedish central bank will start this quantitative tightening process well ahead of the first rate hike. That of course would set it apart from its peers which are more likely to initiate the process after the rate hike cycle has started.

But despite some expectations to the contrary, for now, policymakers are sticking to their previous plan to keep the size of the balance sheet largely unchanged this year. However, we suspect that this guidance may well change before long. The statement reveals that three committee members preferred to reduce the volume of planned reinvestments from next quarter, to allow a passive reduction in the balance sheet size.

In short, we expect a gradual quantitative tightening process to begin at some point this year, followed by a rate hike in the first few months of 2023.

Riksbank continues to signal the first rate hike in 2024



Krona can recover in the short run, but upside capped in the medium run

The Riksbank sent a pretty clear signal to markets today: a change in its monetary stance is not imminent and won't happen unless there is strong evidence that inflation is set to remain higher for longer. Considering the global central bank backdrop, it is a firmly dovish message, and if it weren't for the krona already being undervalued and likely oversold, the spike in EUR/SEK would have probably been more pronounced.

On the back of this short-term undervaluation (around 2% vs the EUR before the RB meeting, in our calculations), we still think EUR/SEK is mostly facing downside risks in the coming weeks, and we expect a move to the 10.30-10.35 area by the end of this quarter should global risk sentiment

stabilise. In the longer run, the Riksbank's dovishness should continue to put a cap on SEK's appreciation, especially considering there is still a good deal of tightening (65bp in the next 12 months) to be priced out of the SEK curve. We now expect EUR/SEK to stay above 10.00 for the remainder of the year.

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