

Swedish Riksbank hikes rates and lifts bond sales amid krona weakness

Sweden's central bank has slowed the pace of rate hikes as it walks a fine line between bolstering the ailing krona and avoiding more damage to the fragile housing market. We think another hike is likely in September, but that might be the last



Erik Thedeén, Governor of the Riksbank

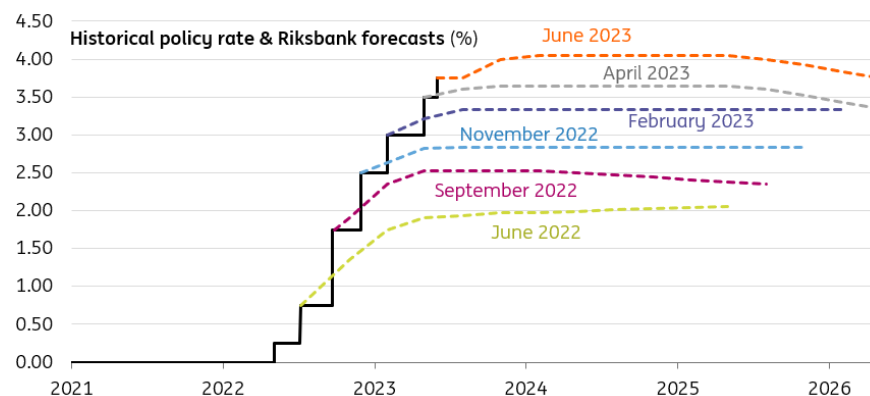
Sweden's central bank has hiked rates by another 25 basis points amid ongoing concerns about the weak krona. On a trade-weighted basis, SEK is roughly 3% weaker than the Riksbank had been predicting for the second quarter on average in its last set of forecasts from April.

On paper, there's nothing hugely surprising about today's decision, though repeated warnings about currency weakness from Governor Erik Thedeén meant there was a tail risk of another 50bp hike this month, not least because the Riksbank meets only twice more this year. That said, the central bank has opted to increase the pace of its sales of government bonds, from SEK3.5bn a month to 5bn, and by the Riksbank's own admission, this is partly designed to help support the krona.

Unsurprisingly those concerns about a weaker currency, coupled with some resilience in both economic activity and house prices, have also led the committee to upgrade its assessment of

future rate hikes. The bank is now forecasting one more hike later in the year, and a 20% chance of another, which would take the policy rate to 4.25%. Unlike at the last meeting, there appears to have been no disagreement on the policy decision among the committee.

Riksbank policy rate forecasts over time



Source: Riksbank

On that basis, there's little reason to doubt that the Riksbank will go ahead with another rate hike at its September meeting. But ultimately Swedish policymakers face a growing trade-off between hiking to bolster its ailing currency, and avoiding a deeper correction in the housing market. Sweden has a much higher share of variable rate mortgages than its peers across Europe, and that means the pass-through from higher rates has been more rapid.

That said, the Riksbank is forecasting another 7% fall in house prices, on top of the 15% we've already seen from the peak. In other words, some further pain is already baked into its latest rates projection.

In short, we expect a rate hike in September, but if the Fed and ECB have paused rate hikes by the fourth quarter, then the Riksbank might be content with keeping rates on hold in November.

Unclear what quicker quantitative tightening means for the krona

EUR/SEK has been volatile in narrow ranges after the Riksbank's announcement today. The positives for the krona are that today's decision to hike was unanimous and that future rate hikes are promised. What is less certain is what today's announcement of accelerated quantitative tightening (QT) means for the krona.

Recall that back in February the Riksbank announced that it would be shrinking its holding of assets from around SEK800bn to SEK200bn over the next three years. In April, it started reducing its holdings of nominal and inflation-linked government bonds by SEK3.5bn per month. Today it has announced that the pace of sales will increase to SEK5bn per month starting in September.

The Riksbank argues that its bond sales will raise yields on government bonds while having little impact on lending and deposit rates. It also argues that by supplying these government bonds back to the market, greater liquidity here will attract foreign investors and support the krona.

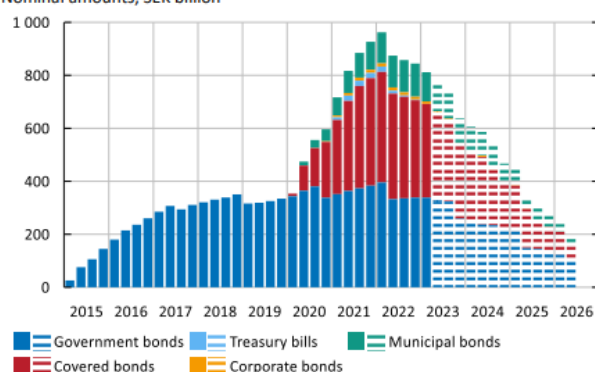
The hypothesis of QT supporting the krona seems to be untested. So far this year, 10-year Swedish Government Bond (SGB) yields have only traded in a +/- 15bp range against 10-year German Bunds – and serves as a reminder that the ECB is also shrinking its balance sheet at the same time.

In all, we suspect that EUR/SEK can stabilise around the current 11.70-11.80 levels. However, with the real estate market proving to be Sweden’s Achilles heel, we doubt that a sustained recovery in the undervalued krona will emerge until much later in the year when there are clearer signs of improvement in global inflation trends. Until that point, domestic risks in Sweden will continue to see the krona trade on a fragile footing.

Riksbank's initial planned sales of government bonds

Figure 3. Riksbank's asset holdings

Nominal amounts, SEK billion



Note. The dashed bars represent a forecast based on maturities and decisions that no asset purchases will be made after 2022 and that government bonds will be sold for a nominal value of SEK 3.5 billion per month.

Source: The Riksbank.

Source: Riksbank

Authors

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@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>.