

European Watch

Riksbank review: one more then let's see

Forecast one more hike

We change our Riksbank forecast. We expect one more 25bp rate hike from the Riksbank in September to 4.0% terminal. We previously forecast 3.75% terminal. We forecast the policy rate at 3.25% at end-2024 (+25bp) and 2.0% at end-2025 (unchanged).

One more heave

The Riksbank today raised its policy rate 25bp to 3.75% as we and consensus expected. This was a step down from the previous 50bp hike, but in-line with the Riksbank's previous guidance. This disappointed the market, which had priced an approximately 50% probability of a 50bp rate hike (conditional on 25bp being delivered). The Riksbank forecasts the policy rate to be increased "at least one more time this year". Consistent with that guidance the Riksbank raised their terminal rate forecast to 4.05%. The Riksbank continues to forecast the first rate cut in late-2025 after core inflation has sustainably returned to target.

Higher terminal, but maybe less conviction

In short, the Riksbank seems to be saying 'probably one more hike then let's see'. While the Riksbank guides to a higher terminal now, they seem to have slightly less conviction in the next hike than the previous one. In the previous policy meeting the Riksbank had used the firmer language that the policy rate would "probably be raised further by 0.25 percentage points in June or September". The Monetary Policy Report suggests to us that the Riksbank is trying to shift even more data dependent."

Hawkish risks from Krona and stronger labour market

The Riksbank responded to stronger than expected core inflation, particularly stronger services inflation. The weaker currency also contributes. The Riksbank argues there are good reasons to expect inflation to slow, with global cost inflation dropping, inflation expectations anchored, and the two-year wage deal in place keeping wage growth under control. So they expect to stop hiking soon. But they present a scenario in which the Krona falls a further 6% over time which – combined with a faster FX pass-through – would in the Riksbank's view require an additional – persistent – 50bp of hikes to a c. 4.5% terminal. The Riksbank does not target SEK, but it matters for the inflation outlook. They also argue the resilience of the labour market could require more hikes.

Speed up bond sales to support currency

The Riksbank seems cautious about hiking rates further given the interest sensitivity of the economy. So, as well as hiking they sped up bond sales from SEK 3.5bn a month to 5bn to support the currency. We suspect this also modestly disappointed market expectations of likely faster sales. They say of faster bond sales "All in all, this can contribute to a stronger krona and improve the Riksbank's." In our view the Riksbank will probably not want to speed up bond sales much more given the pace of decline of the balance sheet now programmed in (**continued on next page with FX commentary**).

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Macro
Europe

Robert Wood
UK Economist
MLI (UK)
+44 20 7996 7415
robert.d.wood@bofa.com

Michalis Rousakis
FX Strategist
MLI (UK)
+44 20 7995 0336
michalis.rousakis@bofa.co.uk

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SEK – dovish Riksbank vs markets. We see downside risks

The Riksbank was on the dovish side of *market* expectations, which helps explain the slight SEK weakness vs. G10 FX following its decision. Into the meeting, markets were pricing a good chance of a larger move and a slightly higher terminal, while the announced Quantitative Tightening (QT) pace was no more hawkish than expected.

What surprised us hawkishly is the Riksbank's guidance to at least one more hike, which we think may be their last one although this will also depend on SEK and the ECB. Still, we were not as convinced (as their terminal would perhaps suggest) by their tone.

SEK's weakness has gone beyond our bearish expectations, yet we still see risks for more and prolonged SEK weakness because: (1) We remain concerned about the highly rate sensitive Swedish households. (2) We see risks around property markets, particularly commercial real estate. (3) We expect a stronger USD and are bearish on risk.

We think Riksbank is between a rock and a hard place unless and until inflation starts falling meaningfully. Our more constructive view on SEK towards year-end partly reflects our base case of inflation falling fast enough in the next months. For this we think the Riksbank has good reasons to count on Sweden's higher rate sensitivity, lower wage growth, and tighter fiscal stance vs. its G10 peers.

We think a lower Riksbank terminal vs. that of other central banks would initially be negative for SEK but, assuming this reflects lower inflation and not a "blinking" Riksbank, this could suggest upside risks for SEK later – by lowering "hard-landing" risks.

To this end, until inflation, particularly core, starts falling meaningfully, markets will likely continue pricing "hard-landing" risks, which would likely result in an increasingly muted SEK reaction to rates (we discuss this in *Do rates still matter for FX?* 26 June 23). And, if inflation proves overly sticky on its way down, Riksbank will not be in an enviable position at all.

Two more comments. On QT: while the announced faster pace of bond sales is unlikely to help SEK much near term, both because it was at best in line with expectations and because we do not think its marginal signaling value for SEK is meaningful at this stage of their tightening cycle, it is nevertheless a positive medium-term development, that addresses some of the client feedback we have received in recent months.

Second, we do not think the Riksbank's intention to potentially hedge part of its FX reserves will have any meaningful impact on SEK. And, to be fair, the Riksbank made clear this should not be seen as part of monetary policy or as an FX intervention.

Exhibit 1: Riksbank policy-rate projections (percent)

Terminal revised up 40bp

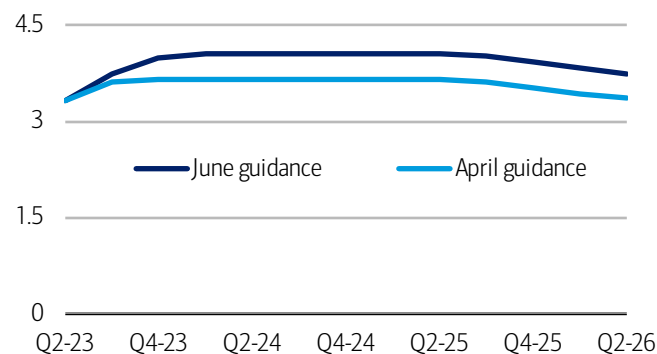
	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26
June guidance	3.32	3.75	3.99	4.05	4.05	4.05	4.05	4.05	4.05	4	3.92	3.83	3.75
April guidance	3.32	3.6	3.65	3.65	3.65	3.65	3.65	3.65	3.65	3.6	3.52	3.43	3.35

Source: Riksbank (Monetary Policy Report June 2023). Note: Values are in percent and show quarterly averages.

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Exhibit 2: Riksbank policy-rate projections (percent)

Higher for longer



Source: Riksbank (Monetary Policy Report June 2023). Note: Values are in percent and show quarterly averages.

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Exhibit 4: Key Riksbank forecasts

Updated forecasts

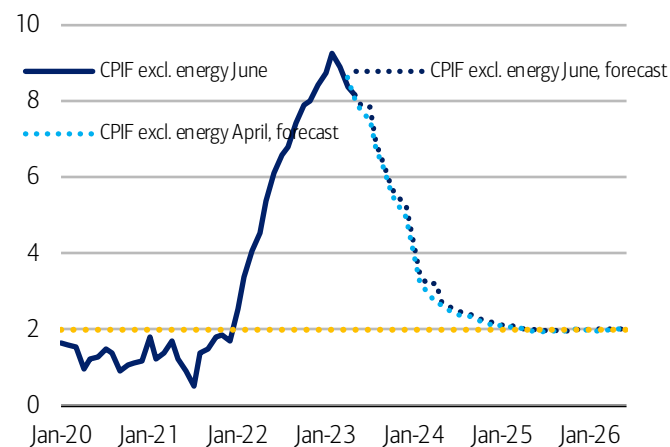
	2021	2022	2023	2024	2025
CPIF	2.4 (2.4)	7.7 (7.7)	5.9 (5.9)	2.4 (2.3)	1.8 (1.8)
CPIF excl. energy	1.4 (1.4)	5.9 (5.9)	7.4 (7.3)	2.8 (2.6)	2.0 (2.0)
GDP	6.1 (5.4)	2.8 (2.6)	-0.5 (-0.7)	0.0 (0.2)	1.8 (1.8)
Household consumption	6.3 (6.3)	1.9 (2.1)	-2.4 (-1.2)	0.7 (0.6)	1.9 (2.0)
Gross fixed capital formation	7.1 (6.0)	6.1 (5.2)	-2.6 (-4.6)	-3.0 (-2.8)	2.2 (2.0)
Final domestic demand	5.4 (5.0)	2.4 (2.2)	-1.4 (-1.4)	-0.1 (0.0)	1.7 (1.7)
Employment gap	-1.3 (-1.3)	0.6 (0.6)	1.3 (0.5)	0.0 (-0.8)	-0.3 (-0.8)
GDP gap	-2.0 (-1.4)	-0.3 (0.2)	1.2 (0.5)	-0.8 (-1.2)	-0.8 (-1.3)
Hours gap	0.6 (0.4)	1.9 (1.5)	0.0 (-0.6)	-1.6 (-2.0)	-1.1 (-1.5)

Source: Riksbank (Monetary Policy Report June 2023). Previous forecasts in brackets. Annual % changes for CPIF, GDP and consumption. Final domestic demand refers to its contribution to GDP growth in percentage points. Employment, GDP, and hours gap show percentage deviation from the Riksbank's assessed potential levels.

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Exhibit 6: CPIF ex energy, percent (Riksbank forecast)

CPIF ex energy stickier through Mar-24

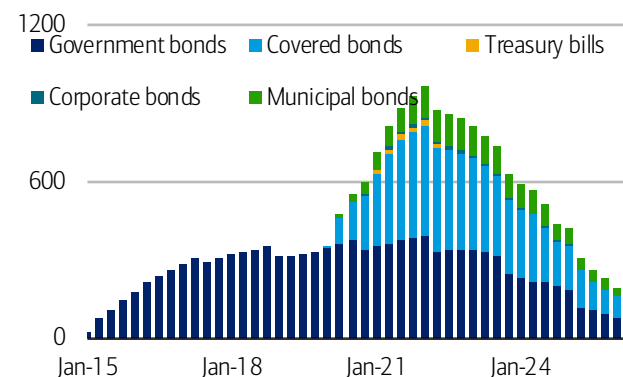


Source: Riksbank (Monetary Policy Report June 2023). Dotted lines are Riksbank forecasts.

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Exhibit 3: Projected Riksbank asset holdings (amounts in SEK billion)

Riksbank to increase its sale of government bonds to SEK 5bn/month

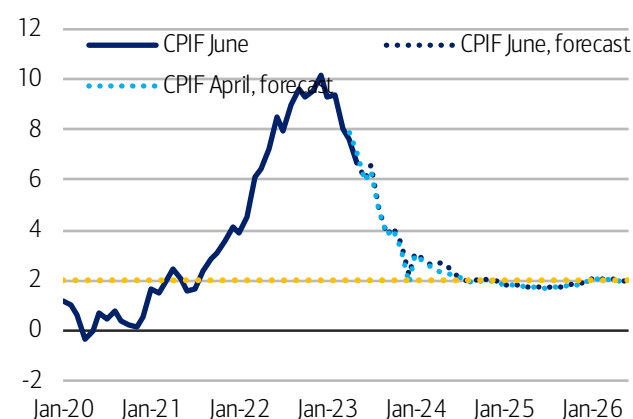


Source: Riksbank (Monetary Policy Report April 2023). Riksbank guidance for Apr-23 onwards.

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Exhibit 5: CPIF, percent (Riksbank forecast)

Small forecast revisions to headline CPIF beyond the front end

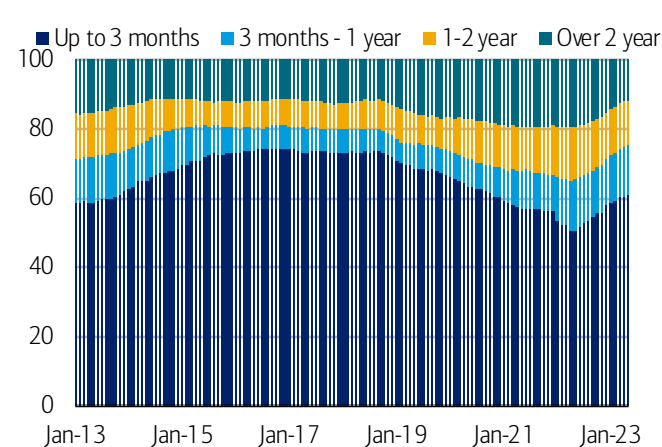


Source: Riksbank (Monetary Policy Report February 2023). Dotted lines are Riksbank forecasts.

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Exhibit 7: Households loans' remaining rate fixation periods, percent

As of May c. 25% of loans had remaining fixation period of more than 1Y

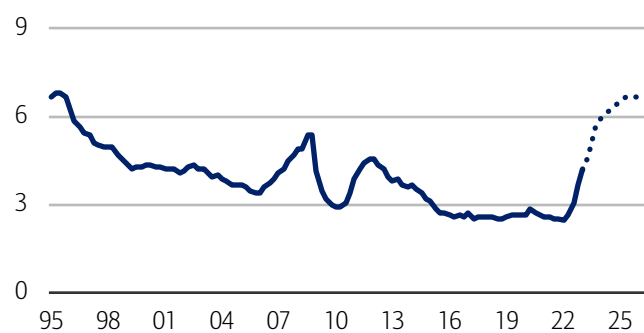


Source: Statistics Sweden via Riksbank MPR June 2023

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Exhibit 8: Interest-to-income ratio, % of disposable income

Interest to-income ratio expected at mid-90s levels

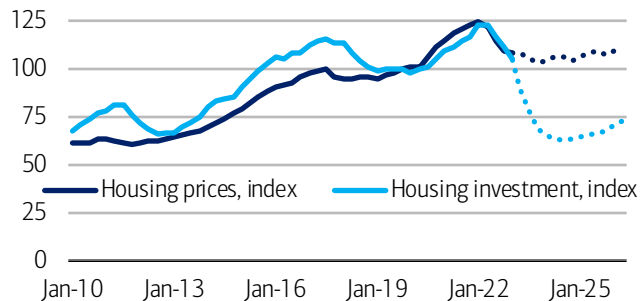


Source: Statistics Sweden, Riksbank. Dotted line shows Riksbank forecast.

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Exhibit 9: Housing prices and investment, 2019 Q4=100

Riksbank expects a meaningful drop in housing investment but house prices to not fall below pre-Covid levels



Source: Statistics Sweden, Valueguard, Riksbank. Dotted lines are Riksbank forecasts.

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