European Watch

Riksbank April minutes: from higher to longer

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Macro
Europe

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From how far to how long

Minutes of the Riksbank's last meeting today show a gradual shift from talking about ever higher spot rates to how long rates need to remain restrictive. Several of the board members highlight that they do not expect rate cuts on the timetable the market does - and this is expected to support the currency. This much was clear immediately post their decision, with Riksbank saying they will only cut once underlying inflation close to target "for some time".

More forward-looking

The debate seems to be between how much weight to place on inflation forecasts and how much on the past data, or put another way how much the past data suggest inflation will persistent and how much the Riksbank can rely on a weak real economy to cut inflation. Rate setters take comfort from anchored expectations and the new two-year wage deal, and generally seem to argue they are likely close to a peak in rates. The importance of the currency in their deliberations seems to have declined since earlier in the year. Their language now describes a standard reaction function: currency is an input to the inflation forecast rather than a target.

The Riksbank minutes seem consistent with our view of another hike to come, and risks around our 3.75% terminal rate call becoming more balanced. Riksbank shifts focus towards need to keep rates at terminal for an extended period, less on the precise peak.

SEK matters but board was less vocal this time

The Riksbank Minutes were interesting, but a non-event for SEK. Although all five Board members stressed SEK's importance—with the Governor saying his view has not changed since February—we think the Riksbank was somewhat less vocal on it vs. in February. But this may have simply been because SEK has been rather stable vs. then.

A positive development has been the recent wage deal, which will likely facilitate a more patient approach hereafter. Such an approach would in isolation lower risks of hard landing and support SEK, in our view. As Dep. Governor Floden's noted: *"it is not obvious that the krona would benefit from larger rate increases if these result in a too rapid slowdown [...]."* While we are encouraged by this development, the stable inflation expectations, and some early (hopefully not premature) signs of stabilization in the housing market, we remain bearish on SEK in the coming months—expecting EURSEK to return near 11.50 by Q3—and until we get clarity around the outlook for inflation and for property markets. A more hawkish ECB could prove a double-edged sword for SEK given Sweden's higher rate sensitivity and tighter fiscal stance. (Cont. on next page.)

50bp in April: the "ayes"

Governor Erik Thedéen: all about inflation

Appropriate to reduce the pace of rate increases but bias still hawkish

"I also think that [...] despite the very high inflation we are still registering, it ***is appropriate to reduce the pace of the increases*** *and adopt a somewhat more open stance. It will still be important to closely monitor new economic information, including the development of the krona [...]. But* ***if*** *the information about Swedish inflation and economic developments points towards* ***increased or prolonged inflationary pressures, I will advocate a higher policy rate than is indicated in our interest rate path.*** *The aim of bringing inflation to two per cent* ***within a reasonable period of time*** *will of course continue to guide me."* (emphasis ours)

Inflation to likely fall quickly but uncertainty after repeated negative surprises

"[...] inflation has not yet shown any clear turning point. It is possible that the recent monthly outcomes give some hope, but this is only individual outcomes. But there are also signs of food prices slowing down."

"[...] most indications are that inflation will fall, and even that it will fall quickly and substantially over the coming year, but inflation is so far still at a very high level and cannot be said to have shown a clear downward turn. We must therefore both consider that inflation will probably fall relatively much going forward and at the same time note that there is considerable uncertainty and that we have been repeatedly had negative surprises."

Wage deal positive news. Riksbank should not disappoint wage earners

"What is new since the previous monetary policy meeting is that important steps have been taken in the collective wage bargaining rounds. [...] indicates that inflation expectations may remain stable, even if individual monthly outcomes for inflation were to be more negative than expected; ***monetary policy can assume on the basis of these wage agreements that there is now less risk of a really bad development in inflation going forward****. I think that we can regard to the design of the collective wage agreements as a sign of good confidence in the Riksbank's actions to safeguard the inflation target. If the social partners are to continue to trust the Riksbank,* ***we must continue to act to bring down inflation within a reasonable period of time. Only then can wage-earners experience real increases in their salaries."*** (emphasis ours)

View on SEK unchanged vs Feberuary

"The value of the krona has varied considerably since the previous meeting, and is now at roughly the same level as then. I addressed the long-term development of the krona at the previous monetary policy meeting, and my view is the same now as then. [...] If the krona continues to weaken, which in turn affects inflation, we need to take this into account in monetary policy. A stronger krona would be welcome, and is also included in our forecasts, as it would make it easier for us to attain [...] 2 per cent inflation."

Deputy Governor Per Jansson

Several bright spots in inflation picture else he would have favoured more hikes

"[...] despite the major negative forecast surprises for inflation excluding energy prices, there are **a number of bright spots in the inflation picture**. These include different indicators pointing to favourable conditions for inflationary pressures to ease quite soon, positive outcomes in wage negotiations and fiscal policy, and inflation expectations that continue to be close to the inflation target in the slightly longer term. **If it was not for these positive elements, I would certainly have considered the adjustment of monetary policy proposed in the draft report to be insufficient.**" (emphasis ours)

Worried about speed of returning inflation to target

"A circumstance I think is particularly troublesome in the context is that it this time in the forecast takes longer for inflation to stabilise close to the target. A firmer monetary policy than is now assumed in the draft report could possibly have changed this."

*"**If target achievement were seriously delayed, the social partners may feel let down**, especially as they now have negotiated responsible nominal wage increases with an expectation that the Riksbank will do all it can to bring down inflation in the fairly near future so that real wages can begin to rise again."* (emphasis ours)

*"But I wish to stress that I am doing this **with some hesitation and I am fully prepared to support both faster and larger policy-rate rises** than those assumed in this forecast, if it proved necessary"* (emphasis ours)

Deputy Governor Aino Bunge

No clear turn in inflation

"My conclusion is thus that inflationary pressures remain very high in the Swedish economy and we have not seen the clear downturn in underlying inflation [...]"

Wages & inflation expectations bright spots, but Riksbank should not disappoint

*"We have also got a new Industrial Agreement and benchmark for the wage bargaining rounds. Even though the level is slightly above our forecast, in my view it considerably reduces the risk of a wage-price spiral in the Swedish economy. One important reason for this is that the agreement stretches over two years. However, the agreement also reflects confidence in the inflation target. In general, we can also see that inflation expectations remain close to target in the medium term, **which is a vote of confidence that the Riksbank now has to live up to.** There will be no return to real wage growth for Swedish wage earners until inflation returns closer to the target."* (emphasis ours)

Potentially more symmetric outlook

*"I share the view that some light can be seen regarding the future inflation trend, not least the wage bargaining rounds and inflation expectations, **which will make the risk outlook more symmetric in the period ahead.** But this will be from a significantly less favourable inflation situation than we expected in February. **Without this light, I would consider, like Per Jansson, that the interest rate would have had to be raised further**."* (emphasis ours)

No rate cuts until inflation close to target for some time

"There will not be any scope for a possible policy rate cut, as indicated by the interest rate path, until underlying inflation has been close to target for some time. The path also clearly indicates the expectation that this is some way ahead."

Acknowledging commercial real estate risks

"One risk that both the Riksbank and Finansinspektionen have long highlighted is the highly-leveraged commercial property sector, which requires continued careful monitoring. Overall, I agree with the assessment in the draft report, namely that the banking turmoil has itself led to some tightening but that the signs have been much clearer in the United States than in Sweden."

50bp in April: the "noes"

First Deputy Governor Anna Breman

Favours a more gradual and forward-looking approach

"[...] I advocate an increase of 0.25 percentage points and a path that indicates further gradual increases in June and/or September. This would allow us to keep our options open for other courses of action later in the year, including the possibility of a return to larger increases if inflation should become entrenched on a high level. At the same time, a gradual approach to further tightening would reduce the risk of negative side-effects.

A well-balanced monetary policy should always be forward looking. *It should be based on an overall view of where the Swedish economy and inflation are headed in one to two years."* (emphasis ours)

Adjusting QT could be another option

"If inflation becomes entrenched on a high level, I will not hesitate to continue gradual increases longer than the path indicates and/or to resume increases in larger steps than 0.25 percentage points. In addition, we can use all our tools, including adjusting the pace of quantitative tightening"

But slower does not necessarily mean lower

"I can easily see a path that peaks at over 3.75 per cent. Moving gradually forward with increases in smaller steps would create space for larger increases later on, if this is what would be needed to bring inflation sustainably back to a low and stable level."

Deputy Governor Martin Flodén

Terminal in sight

"[…] monetary policy needs to continue to be tightened, but that we are probably approaching the endpoint for rate rises."

Favours a more gradual approach on 1) weaker demand...

"First, we see that domestic demand is weakening rapidly […]. My assessment is that household consumption in particular but also business investment are of greater significance for inflation than the export industry."

2) Wage agreement and stable inflation expectations

"Second, we still see, and now even more clearly, that inflation expectations and wage formation are compatible with the inflation target of two per cent."

3) Financial-stability concerns given Sweden's high rate sensitivity

"Third, we need to consider the recent turmoil in international financial markets, linked in particular to problems in certain foreign banks. We know from before that the Swedish economy is interest-rate sensitive. Both households and companies are highly indebted with short interest-rate fixation periods. The Riksbank's rate hikes therefore mean that cash flows will rapidly deteriorate for many households and companies. Household consumption, housing construction and the commercial property sector are therefore expected to be substantially affected, and more in Sweden than abroad despite the Riksbank's rate rises being smaller than abroad."

Risks of a gradual approach are 1) weaker SEK (but not obvious if hard landing)

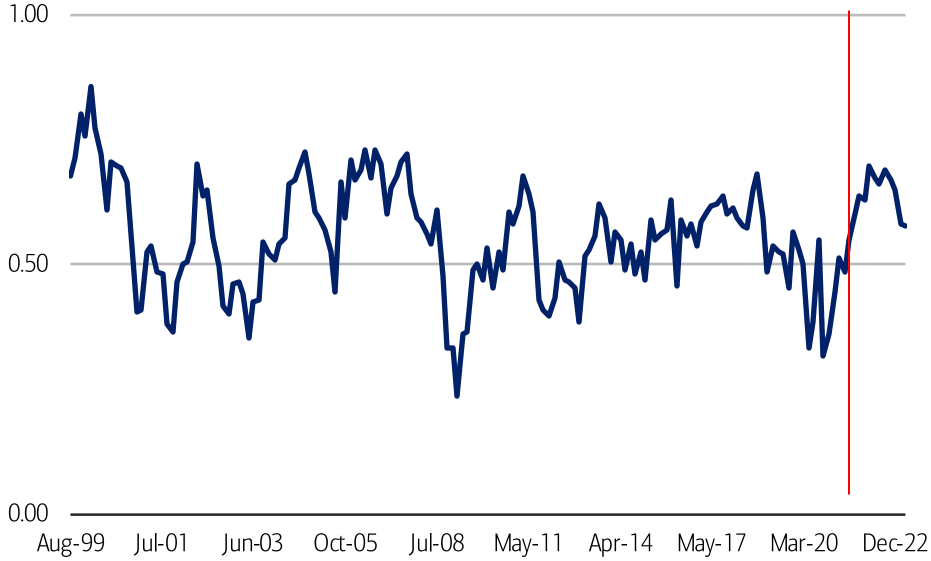
"Market expectations are that the rate will be raised by 0.5 percentage points today. An increase of 0.25 percentage points ***would probably cause the krona to depreciate, at least in the near term.*** *And this would in turn exert more upward pressure on inflation via import prices. I see this as the strongest argument against the monetary policy strategy I am advocating.* ***But it is not obvious that the krona would benefit from larger rate increases if these result in a too rapid slowdown in the Swedish economy****."* (emphasis ours)

2) Riksbank seen as "blinking"

"[…] an unexpectedly small rate increase could be seen as the Riksbank having changed its policy rule and now attaching less importance than before to fighting inflation."

Exhibit 1: BofA Riksbank mood indicator (Riksheard) (Back-tested)

Riksheard fell slightly, making a new post Feb-21 low. But still in hawkish territory



Source: BofA Global Research. Note: Riksheard is scaled from 0 to 1, and reflects the proportion of 'hawkish' sentences in each publication. A score of 0.5, for instance, means half of the sentences were hawkish. The indicator identified as Riksheard is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Global Research. This economic indicator was not created to act as a benchmark. This performance is back-tested and does not represent the actual performance of any account or fund. Back-tested performance depicts the theoretical (not actual) performance of a particular strategy over the time period indicated. No representation is being made that any actual portfolio is likely to have achieved returns similar to those shown herein. For more details, please see European Viewpoint: Riksheard: doves without a tool.

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