

Riksbank stands firm with dovish tone despite economic data improvements

The Swedish krona has hovered in narrower ranges in Q2 compared to Q1 2021 as much of the positive incoming data was offset by a clear message from the Riksbank that it will maintain loose monetary policy over the 3-year horizon. EURSEK traded between 10.09 and 10.20 for most of May, while USDSEK remained between 8.25 and 8.50 mostly (chart 1).

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These ranges represent stronger levels than seen at the end of March, when virus cases spiked by over 100% in the space of less than a month. This led to a tightening of lockdown measures, however, Sweden's activity held up significantly better despite these stringent measures compared to its peers, with output growing by 0.8% in Q1. In comparison, both the eurozone and Norway had experienced a 0.6% QoQ contraction in output in the first three months of the year. According to Bloomberg estimates, Sweden is now set to return to pre-pandemic output levels in Q2 2021 while Norway isn't set to reach that milestone until Q3 2021 at the earliest and the European Central Bank expects euro area growth to only return to pre-pandemic levels in mid-2022.

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Sweden's quick recovery should support the Swedish krona going forward, while the currency also benefits from a broader global recovery given that it is an open economy.

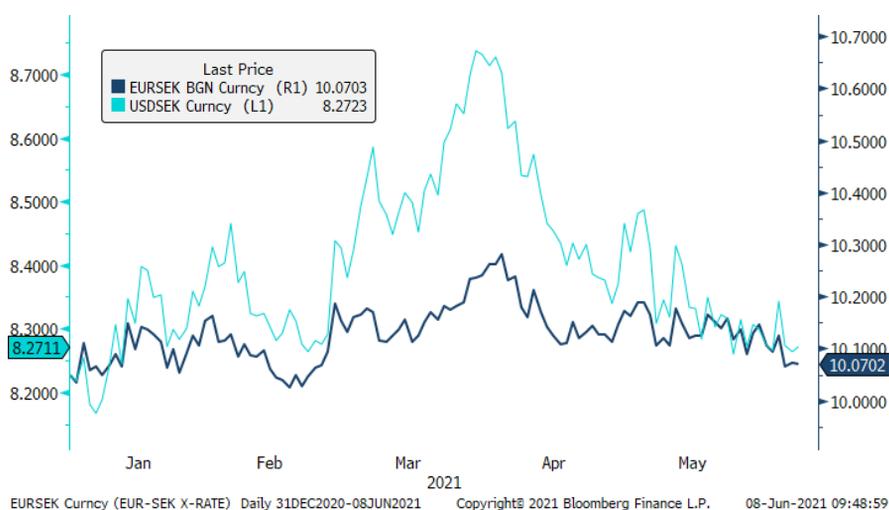
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However, the SEK rally should be somewhat contained by the Riksbank's dovish policy stance, which leads us to maintain our forecasts of a mild rally in the Swedish krona over the coming year. The appreciation in the krona will be more visible against the dollar than the euro given our expectation of euro appreciation also due to procyclical reasons, while we believe the [US dollar will continue to weaken](#) over the course of 2021.

Monex's June forecasts

Currency Pair	1-month 30 th Jun 2021	3-month 31 st Aug 2021	6-month 30 th Nov 2021	12-month 31 st May 2022
EURSEK	10.15	10.1	10.1	10.05
USDSEK	8.3	8.2	8.2	8.1
NOKSEK	1.025	1.031	1.041	1.058

Chart 1: Swedish krona breaks out of Q1 weakness as virus situation stabilises, but trading ranges remain tight



Source: Bloomberg

Sweden's resilience to Covid-19 containment measures continues

Q4 2020 saw a 0.2% contraction in output in quarterly terms, which is milder than the contraction seen in other European countries, indicating a certain economic resilience to the second wave. This was reinforced in Q1 2021 when GDP printed at 0.8% QoQ despite the third wave, as mobility in Sweden was unfazed by the latest measures (chart 2).

“ Combined with the loose containment measures throughout the first wave, **Sweden's overall output loss due to the pandemic was limited.** ”

This is reflected in the labour market data as well, which shows the Swedish PES unemployment rate (which considers furloughed workers as employed) has been consistently falling since July 2020, with the exception of a slight uptick in December 2020. The unemployment rate that accounts for furloughed workers tells a different story, however, as the number of furlough applications have risen consistently between November 2020 and March 2021. This hasn't led to negative GDP growth rates though, which highlights the effectiveness of the policy measures, while the unemployment rate is showing signs of recovery in April with the unemployment rate falling from 10% to 9.4% and the PES unemployment rate falling from 4.0% to 3.6% in April.

Looking forward, the trend of firming economic data should continue as the easing of restrictions occurs gradually over the coming months

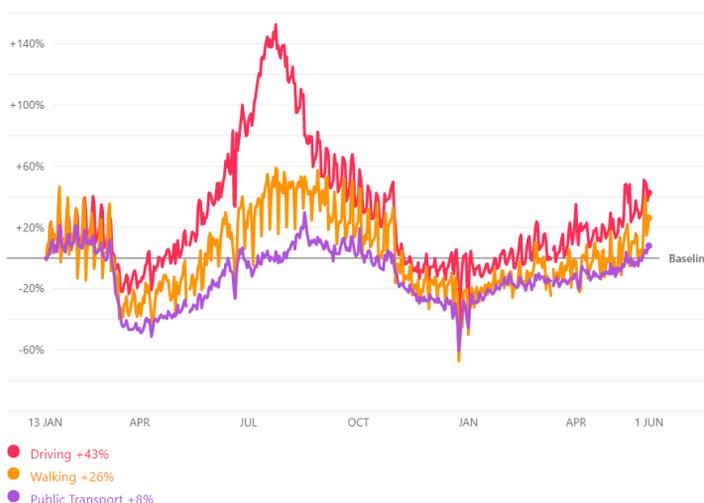
Sweden was one of the last Nordic countries to begin easing restrictions on June 1st, with sports events, concerts, cinemas and markets opening their doors to receive guests outdoors again, while outdoor hospitality hours have been extended as well.

Sweden will likely be later than its neighbouring countries in easing all restrictions as the government has stated it will wait until at least July for wider easing, while other Scandinavian countries have eased several times in the last months. Given Sweden's resilience to the measures, however, we expect this to have a more limited impact on overall growth, which means any SEK losses from slower reopening should be muted. Additionally, the procyclical nature of the currency means SEK should benefit from reopening phases elsewhere, particularly in key trading partners.

While Sweden still has the highest number of infections per capita in the EU, it is better placed in terms of hospitalisations and Covid-19 related deaths. The lower rise in deaths and hospitalities reflects the take up of vaccines among the most at risk. This means that the level of new cases at present is unlikely to derail the government's plans to reopen, especially when viewed in the context of the Swedish government expecting all adults to be able to get at least one dose of the vaccine by August 15, which is reasonable given the progress so far.

Chart 2: Apple's mobility trends show significant increase since January 2021 despite further tightening of lockdown measures

Source: Apple's mobility trends



Despite the constructive data, the Riksbank's clear message holds back any long-term SEK boost coming from rate hike expectations

Although the Riksbank will welcome the latest batch of positive data, they are unlikely to consider this a reason to change their policy path.

They will most likely hold interest rates for both this year and next, in line with the latest rate projections, and the central bank's stance on inflation means they are not afraid of keeping their quantitative easing programme running until the expiry date of December 2021 either. Echoing the Federal Reserve and the European Central Bank, the Riksbank stated it will look through any overshoots in inflation currently as they expect the rate of price growth to move back below their 2% target in the second half of the year. The latest monetary policy report stated it would take until at least the end of the 3-year long forecast period before inflation is expected to be more permanently close to the target of 2%, adding further weight to the argument that the central bank won't hike rates before 2023. **Riksbank Deputy Governor Per Jansson even stated there is:**

“still some way to go before I [he] would be worried about inflation situation on the upside”.

The Riksbank remains towards the back of the pack when it comes to policy normalisation among G10 central banks. With policy expectations remaining low for the Riksbank and the domestic reopening taking place at a gradual rate, the Swedish krona remains at the mercy of the synchronised global economic recovery into the summer months as global factors remain more important for the currency.

Meanwhile, the monetary policy divergence between the Norges Bank and Riksbank has increased since our last SEK outlook in Q1, as the Norges Bank brought forward expectations for a rate hike from the start of 2022 to late 2021.

“ Due to this, we continue seeing more upside in **NOKSEK** over the medium-term horizon, as reflected in our latest forecasts. ”

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