

Riksbank Preview: September 2020

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Currency Comments the Focus

21 September, Tim Davis

Tomorrow's Riksbank meeting is expected to be less eventful than the previous meeting in July when QE was extended until June 2021. In all of the previews that we have read through, the base case in each is that GDP forecasts are revised higher while the repo rate path is unchanged and left flat at 0% through the policy horizon (TD Securities see a risk of an increase to some of the repo rate projections in 2023). Along with the consensus we also expect no dissents (none of the previews we read flagged any risk of dissent).

Negative rates are likely to be left on the table but arguments in the past have focused on negative rates being more effective when demand can be more easily stimulated. At present with Covid-19 continuing to weigh on confidence, negative rates are seen as less effective than they would be when a vaccine is available with QE and forward guidance seen as the primary tools at present. QE is seen to help more than negative rates as it helps contain volatility and illiquidity in financial markets which can become more systemic and feedback into fear in either other related markets or even if widespread enough can impact business and consumer confidence.

The Riksbank's corporate bond and mortgage bond purchase programme is seen as much more controversial than the sovereign bond purchase programme and the level of criticism has been a lot more widespread than other central banks that have launched QE programmes over the previous few months. However, with purchases only actually beginning this month, it is unlikely there will be any near-term changes to the programme.

Outside of the repo rate forecasts and any discussions surrounding negative rates, the main risks lay in any comments on the currency. Ingves has sounded unconcerned about the appreciation of the krona recently so it would be a surprise if the Riksbank changed its tone and flagged concerns over the strength of the currency. Indeed, if the Riksbank was that concerned with the level of the currency, it may even be concerned enough to put in a token chance of a rate cut in the repo rate forecasts rather than leaving them flat through 2023.

mni Central Bank Watch - Riksbank

MNI Riksbank Data Watch List						2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
Inflation		Current	3m ago	3m Chg	6m ago	6m Chg				
CPI	% y/y	0.8	0.0	👆	1.00	👇				-0.88
CPIF	% y/y	0.7	0.0	👆	1.00	👇				0.31
CPIF Excl Energy	% y/y	1.4	1.2	👇	1.6	👇				0.06
PPI	% y/y	-4.9	-3.0	👇	-0.4	👇				-1.17
Economic Activity		Current	3m ago	3m Chg	6m ago	6m Chg				
Swedbank Manuf PMI	Index	53.4	40.4	👆	52.9	👆				0.72
Private Sector Production	% y/y	-4.1	-9.4	👆	1.90	👆				-0.07
Economic Tendency Survey	Index	87.0	65.1	👆	99.60	👆				0.29
Swedbank Service PMI	Index	56.6	41.4	👆	56.20	👆				1.01
Monetary Analysis		Current	3m ago	3m Chg	6m ago	6m Chg				
M3 Money Supply	% y/y	16.21	14.57	👆	7.42	👆				2.13
Lending to HH	% y/y	5.20	5.29	👇	5.11	👇				0.02
Lending to Non-Fin Corp	% y/y	5.32	5.80	👇	4.61	👇				0.49
Avg. new HH loan rate	%	1.50	1.56	👇	1.53	👇				-1.25
Consumer / Labour Market		Current	3m ago	3m Chg	6m ago	6m Chg				
Retail Sales YoY	% y/y	3.89	-2.73	👆	2.92	👆				1.05
Consumer Confidence	Index	84.4	78.0	👆	99.5	👆				-0.19
Unemployment Rate	%	8.8	9.0	👇	8.20	👇				0.42
Household Consumption	% y/y	-3.7	-11.2	👆	0.80	👆				0.02
Markets		Current	3m ago	3m Chg	6m ago	6m Chg				
Equity Market (OMXS30)	Index	1790	1630	👆	1669	👆				1.45
Sweden 10-Y Govt Bond	%	0.00	-0.03	👆	-0.27	👆				1.65
SEK Yield Curve (2s-10s)	bps	33.1	25.5	👆	4.9	👆				1.72
SEK KIX TWI	Index	116.23	119.00	👇	122.62	👇				-1.31

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Sell Side Previews (A-Z)

Bank of America

- BofA “expect the Riksbank on hold at its Sep meeting, but we cannot rule out a cut down the road.”

Barclays

- Barclays notes that the Riksbank Executive Board “is likely to acknowledge Sweden’s continued recovery following the initial rebound from the pandemic, reflecting this in more optimistic macro forecasts and sounding cautiously constructive overall.”
- However Barclays does not “expect any explicit following in its forward guidance. We also expect the bank to resist going back to negative rates, and emphasize the use of QE instead, should the economy deteriorate.”

Danske

- Danske expects “upward revisions to the economic outlook, but both the repo rate path and the QE programme running to mid-2021 are likely to remain unchanged.”

Handelsbanken

- Handelsbanken “expect the Riksbank Executive Board to make no changes at its monetary policy meeting on September 21 (with announcements following on September 22), both in terms of the policy rate and asset purchases”

Nordea

- Nordea notes that “it is becoming increasingly clear that the economic crisis is considerably milder than expected. The Riksbank will probably sharply revise up its GDP forecast for this year and maybe also for the next. At the same time, the labour market forecast will be adjusted in a positive direction.”
- Nordea does not expect any changes to the repo rate path or QE programme.
- On the exchange rate, Nordea notes that “the Riksbank has not expressed major concern over the SEK exchange rate or inflation expectations. This is probably because the bank is still more preoccupied by the coronavirus crisis. And the Riksbank is unlikely to again use the exchange rate to lift inflation when the SEK is already trading at comparatively low levels.”
- However, Nordea notes that “the QE-programme could be adjusted next year, with reduced purchases of mortgage and corporate bonds and increased purchases of government bonds.” Nordea points out that “in the light of the quicker-than-expected economic recovery, rising housing prices and still high household credit growth the Riksbank’s purchase of mortgage bonds is controversial.”
- Nordea states that “we’re not there yet, but when the challenges become more urgent, the Riksbank’s Executive Board will likely be divided. Jansson and perhaps also Flodén will probably be ready to lower interest rates. And for tactical reasons, the other members will be reluctant to entirely dismiss a rate cut in its communication. The market is therefore wise to discount some probability of a rate cut. Still, we believe that the majority of the Executive Board members, headed by Ingves, are quite a long way off from lowering interest rates.”

Morgan Stanley

- MS note that “on better-than-expected data, we see the Riksbank upgrading its central projections next week. Still, we see further labour market deterioration ahead, and a softening of the pace of the recovery in the autumn.”
- However, MS argues that “despite the mechanical lift to growth and the inflation path, we think that the Riksbank will strike a cautious tone. We think that it will flag downside risks – primarily from COVID-19 – and conclude that accommodative policy will remain in place for as long as needed to support the ongoing recovery and boost inflation back to target. We see further emphasis on risks from long-term scarring, “as well as the reiteration of its message on the importance of maintaining confidence in the inflation target.”
- Further out, “weak wage growth, currency appreciation and a softer recovery will all, we think, push inflation expectations down, prompting Riksbank action. We see negative rates ahead again, although we now see a risk of later action, compared to our current 1Q21 call.”
- On the currency, MS “think that the Riksbank will likely stick to its stance that SEK is one factor which affects the inflation outlook but it is not concerned with the SEK strength seen so far... However, should it add to the press statement that it is closely monitoring the exchange rate, or stress that “it is important the krona develops in a manner compatible with inflation remaining close to the target” – the language last used in the statement in 2018 – then it would be a change in tone and a surprise to markets”

SEB

- SEB’s main scenario [to which SEB attaches a 90% probability] is that “the Riksbank will continue to purchase bonds according to current plans, but we think that the bar for expanding the programme is low if growth weakens and market volatility returns.”
- SEB expect the repo rate path “to continue to signal an unchanged repo rate of zero for the foreseeable future. The board is likely to continue to say that rate cuts are possible if they are seen as an efficient measure, but that the balance sheet is currently the preferred policy instrument.”
- SEB also expects “the board to repeat the message from July that the QE programme will continue as planned until the middle of next year and that all policy tools are ready for use if the outlook for inflation and growth deteriorates.”

SocGen

- SocGen notes that the Riksbank “The Riksbank started corporate bond purchases last week but is not expected to make any changes to rates or forward guidance.”

Swedbank

- Swedbank states that it doesn’t “think the repo rate and rate path will be touched, nor will other monetary policy measures such as asset purchases. The message that the Riksbank is prepared to take further action, including cutting the repo rate if needed, will again be mentioned”
- Swedbank also notes that “the inflation forecast (CPIF) will probably be revised slightly higher in the near term and given that economic development has been just about what the Riksbank estimated, the underlying trend should stay about the same. The stronger SEK suggests a slight downward revision going forward, however.”

TD Securities

- TD Securities notes that “while the most likely outcome is that the Riksbank leaves its policy rate projections unchanged and flat across the forecast horizon, we think the risks lie toward a small upward lift to the 2023 numbers rather than another more dovish shift as the Riksbank likely feels that it’s done enough to support the recovery.”

MNI Policy Team Insights

MNI POLICY PREVIEW: Riksbank Policy Move Unlikely; Focus On Forecasts

21 September 2020

With Sweden's economy faring better than initial worst expectations, the Riksbank looks set to leave policy unchanged at its September meeting, focusing on continued liquidity for the real economy, having already front-loaded its bond buying envelope through until summer 2021.

With rates at 0% and the already announced total SEK500 billion of potential bond buys spread across the range of fixed-income assets, the Riksbank has provided reassurance that it is committed to its easing program for many months to come.

This has left policymakers to focus on its main priorities for now – ensuring liquidity flows to the corporate sector and households, whilst underpinning stability across the financial markets.

"The main focus is to get ... out liquidity in the economy so that the market functions well," rather than focus on the policy rate which has been left at zero, Deputy Governor Henry Ohlsson said in an MNI interview published last week.

Outlining the reasoning behind the early announcement of the asset purchase plan, Governor Stefan Ingves said it was to make "absolutely clear for market participants what would happen in the course of the summer."

"In the event nothing much at all happened in the summer and given the uncertainty that was a good sign," he added.

With the summer having run smoothly and the Riksbank only starting its corporate bond purchases this month, there is little or no pressure on the board to do more at its September meeting.

FORECASTS

The focus will fall instead on the updated forecasts and analysis in the quarterly Monetary Policy Report (MPR) and whether the board reinforces its line that it could move the policy rate back into negative territory as and when any recovery arrives to try and turbo-charge any pick-up.

For now, however, the majority view on the board has been to focus on asset purchases, with the policy rate a side issue. The July MPR showed the Riksbank board's collective judgement was that the Repo rate would stay at zero through to the end of the three-year forecast period, and a repeat in the September forecast is plausible.

Inflation – as measured by CPIF -- was seen holding below the 2.0% target, only reaching 1.4% in 2021 and 2022, with an acceptance that the measured inflation basket weights could be misleading adding to the foggy over the data.

MNI INTERVIEW: Covid Shifts Raise Price Doubts-Riksbank Deputy

- Dep Gov Ohlsson Sees Both Upside and Downside Price Risk Potential

By David Robinson

11 September

Uncertainty over the accuracy of Sweden's inflation measures could persist for years due to changes in consumption patterns during the Covid pandemic, and policymakers must analyse data carefully as some evidence suggests its impact will not only be disinflationary, Riksbank Deputy Governor Henry Ohlsson told MNI.

"If the changes in the consumption pattern are permanent it is really important to think about the production of price statistics because then there will be a need as quickly as possible to try and assign new weights when producing these statistics," he said.

"To determine what has happened we also need to know the consumption patterns, we need to know the budget shares of different goods and services," Ohlsson said, noting that statistics gatherers would need to look at ways of accelerating data collection on spending patterns if the behavior changes endure.

Sweden kept its economy largely open throughout the pandemic but that did not prevent big shifts in behaviour and spending, some of which may make it easier for businesses to raise some prices to consumers.

In the meantime, Ohlsson said the question was whether producers have "reduced their prices because of the lower activity or have they increased their prices to compensate for the lower demand?"

"You have two possibilities here and I guess we will have to wait a while to see what is really going on. We have anecdotal evidence of both types of reaction."

Inflation on the Riksbank's target CPIF measure, consumer prices with a fixed interest rate, fell to 0.5% in July from 0.7% in June, but these headline numbers are based on weights for consumer spending patterns from two years ago.

PRE-COVID CONCERNS

Even in pre-Covid times Ohlsson said there was uncertainty about the inflation data, which the Riksbank tried to take into account. But now that uncertainty has intensified.

"The inflation numbers we get are always uncertain. This year the uncertainty is bigger than before (but) you should always interpret these numbers with care and more care this year than previous years," he said.

MNI INTERVIEW: Riksbank Focus Liquidity, Not Rates-Ohlsson

By David Robinson

11 September

The Riksbank remains focused on providing ample liquidity and ensuring a fully functioning financial system rather than lowering the benchmark interest rate, Deputy Governor Henry Ohlsson told MNI.

"The main focus is to get ... out liquidity in the economy so that the market functions well," Ohlsson said.

"Our contribution to the policy efforts to mitigate the economic crisis is to see that the financial system is in order," he added.

The Riskbank unveiled a program of asset purchases in the early stages of the Covid pandemic, then extended the overall envelope to SEK500 billion taking it through to June next year, while leaving the policy rate at zero.

With headline inflation running well below target the expansionary policy chimes with the central bank's price mandate.

"We have been below the (inflation) target but getting liquidity out and doing these other things, that is an expansionary monetary policy," Ohlsson said, standing full-square behind Governor Stefan Ingves's approach to handling the pandemic fallout by reassuring investors of the central bank's presence in markets.

"We have also a policy effect of doing this and we expect that we move towards the target. And we do these things rather than change the repo rate," he said.

MNI POLICY: Riksbank's Ingves-Balance Sheet Key, Krona Less So

By David Robinson

3 September

Riksbank Governor Stefan Ingves said the Swedish central bank has focussed on balance sheet expansion rather than cutting the policy rate in response to the Covid-19 pandemic and recent krona appreciation was a secondary issue.

Ingves, speaking at a UBS event, did not rule out taking the policy rate, currently at zero, to negative but said that they took the view that the most efficient way to ensure credit was available and effective interest rates low across the economy was via committing to a wide range of asset purchases, including mortgage backed securities and corporate bonds.

On its trade weighted KIX-index the krona has moved from 124.3629 on Sept. 3 2019 to 115.4195 on Sept. 3 2020, a 7.2% rise where a lower number represents a currency appreciation.

"What has been really, really important for us is to ensure that we establish orderly markets domestically and that we ensure that there is ample supply of credit in the Swedish economy," Ingves said.

"From that perspective what has happened with the krona has been secondary but we, of course, take note of the fact that for once the krona has appreciated," he added.

The Riksbank came out of a prolonged period of negative rates only nine months ago.

"When it comes to negative rates there is a limit to how negative you can go," Ingves said, "We certainly know how to do it but our judgement was that our policy mix was more complicated but would produce a better result in terms of keeping rates low in the economy as a whole."

The Riksbank has set out a swathe of lending and purchase measures which will take it deep into next year to complete, including setting aside SEK300 billion for the purchase of government, mortgage and municipal bonds and commercial paper. It announced on Sept. 1 that it would start purchasing corporate bonds this month.

With credit spreads fairly stable Ingves was asked why the Riksbank was continuing to expand asset purchases and to move into corporate bonds. He argued that central banks should be ahead of the game in developing expertise and infrastructure to carry out fresh policies rather than playing catch up when things deteriorate.

Ingves said that in his many years in central banking "Each and every time we talked about and felt that we might have to do this and that in the future the way the future presented itself we also ended up doing it."

MNI INTERVIEW: Rate Cut No Krona Help For Riksbank: NIER Head

- Ex-Riksbank Research Chief Heden Westerdahl Sees Confidence Rising But Could Be Temporary
- Westerdahl Doubts Return To Negative Rates Would Get Inflation Back To Target, Drive Down Kron

By David Robinson

7 August

If the Riksbank were to return its policy rate to negative territory it might not be effective in getting inflation back up to target and weakening the krona, Ylva Heden Westerdahl, Director of Forecasting at Sweden's National Institute of Economic Research, told MNI in an interview.

The recent rebound in the Swedish krona, following a prolonged period of weakness, appears problematic for the central bank with inflation undershooting target and export growth subdued. But Heden Westerdahl, a former research division head at the Riksbank, pointed out that the policy rate does not reliably drive the krona and the currency's level does not reliably determine export strength.

Cutting the repo rate back into negative territory from its current zero percent or adding other stimulus might deliver neither inflation to target nor any real boost to exports.

"My personal take is that I wonder whether it will be effective," Heden Westerdahl commented. "You have structural factors driving down inflation and now you also have weak demand that will hold back inflation. So, I think it will be very difficult for monetary policy to increase inflation, even if the krona would weaken."

UNRULY KRONA

Some policymakers have expressed sympathy with the idea of a future rate cut to combat currency appreciation, with Riksbank board member Martin Floden cited in the July Executive Board minutes as arguing that "it may be appropriate going forward to cut the policy rate, for example if the krona continues to appreciate quickly."

Extensive academic research on interest parity has, however, struggled to find a reliable correlation over policy horizons between rate differentials and currency levels. "Carry trade, all capital flows. It is very, very difficult to see what is driving the krona in the short term. In making a forecast just doing a random walk from where you stand is usually the best forecast - which is just a straight line from where you are," Heden Westerdahl said.

Swedish exporters also often use imported raw materials or other items, undermining any simple assumptions that a softer currency would drive down export prices.

"We had the weaker krona and we thought exports would go up much quicker than they did when we had the upturn of the economy from 2016 until 2019," Heden Westerdahl told MNI. She added that overseas demand was simply not there and the strength of that demand will be the key going forward

The Riksbank's trade weighted currency index, the KIX, hit 114.652 at the end of July, putting it back at the kind of levels seen in early 2018 having started the year at 120.9248, where a lower reading indicates an appreciation.

UNCERTAIN RECOVERY

The NIER's latest Economic Tendency Indicator for July, its survey of Swedish business, showed economic activity picking up from its lows but still at historically low levels, with the headline index rising to 83.4 from 75.3 and with confidence indicators for capital and consumer goods producers back to near historic averages.

Compared to the very weak level of exports in the second quarter, when foreign markets were locked down, exports are set to recover as firms that have held back begin to reinvest. "Now they have some pent-up demand, we think, at least for the third and fourth quarter. And usually that will benefit Swedish exports because we have a lot of investment goods in our export basket," Heden Westerdahl said.

Forward looking indicators are pointing to a continued improvement in Swedish output. "Expectations, expectations of orders and production, they are in positive territory. Those for manufacturing and for the service they are at least now, for July, fairly confident looking forward but who knows if this will last," she cautioned.

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