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Riksbank Ponders Own Easing Template

SNB and ECB chart very different paths for continental policy

- May inflation surprises to keep Riksbank vigilant
- Long-term price path has upward slope; SNB remains an outlier
- SEK undervaluation impact on price outlook no longer severe

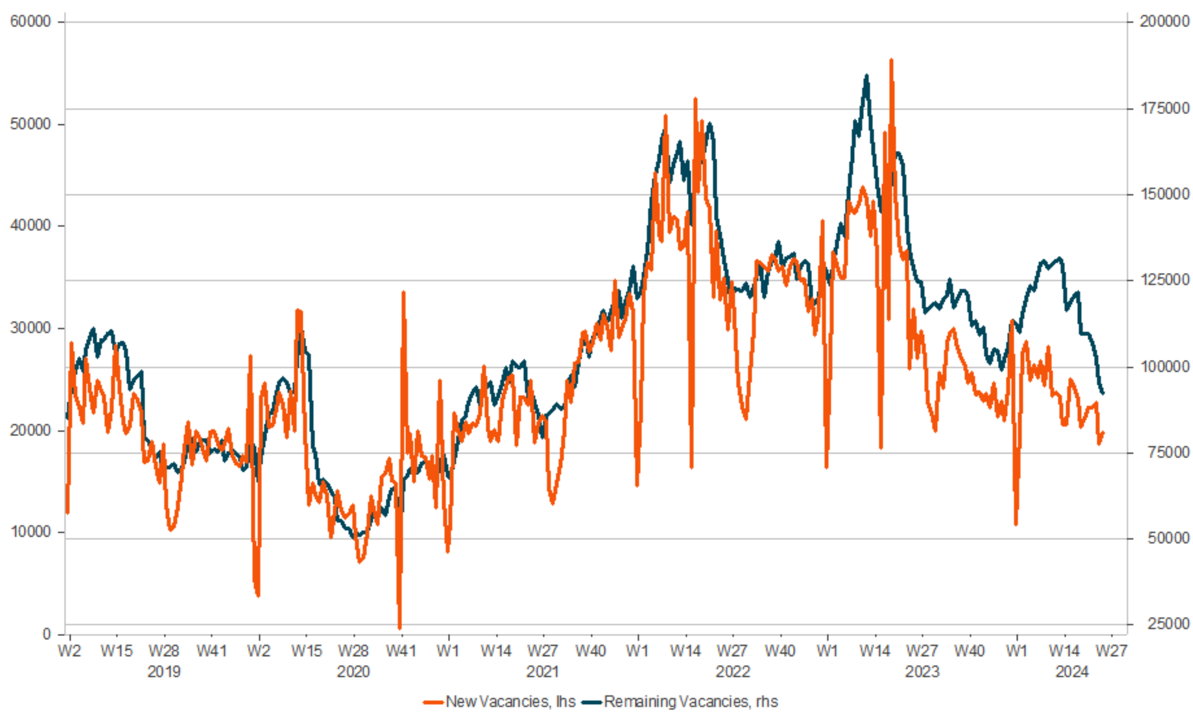
Riksbank forecast refresh likely to indicate price persistence

The Riksbank decision on Thursday rounds off the June policy cycle for Western Europe. Yet again, the only surprise came from the Swiss National Bank, as it all but doubled down on its view that inflation would continue to remain firmly anchored below the headline inflation target over its forecast horizon despite higher short-term prints and the likelihood of higher equilibrium rates. Elsewhere, there was clear reluctance to reinforce a dovish message. Norges Bank more or less ruled out cuts for the year, the Bank of England merely opened the door to a move in August, and the European Central Bank's s cut was dubbed ‘hawkish’ amid the uplift in the inflation view across its forecast horizon.

We concur with the current market view that the Riksbank, despite also having cut rates ahead of the ECB, is in the inflation vigilance category, along with its peers in Frankfurt, Oslo and, to a lesser extent, London. Guidance from the May decision was already relatively subdued, indicating only two more cuts for the rest of the year. The subsequent strong inflation reported for that month put paid to any hope of bringing guidance forward.

However, given the state of Sweden's labour market, which continues to show clear weakness in new vacancies and total vacancies (exhibit #1), we doubt that there will be tilt away from the prior bias, either. The Executive Board will likely repeat that “Inflation expectations are firmly anchored and wage increases are moderate." However, similar to the situation the BoE has faced, the Riksbank recently warned that low response rates to Labour Force Surveys (LFS) is hampering the accuracy of forecasts and policymaking. While not as poor as in the UK, the response rate in Sweden is "clearly lower than the EU average". Given the well-documented labour supply challenges in Europe, the burden of proof is against lower wage growth and a looser labour market, especially in the services sector.

Exhibit #1: Sweden Labour Market Softening

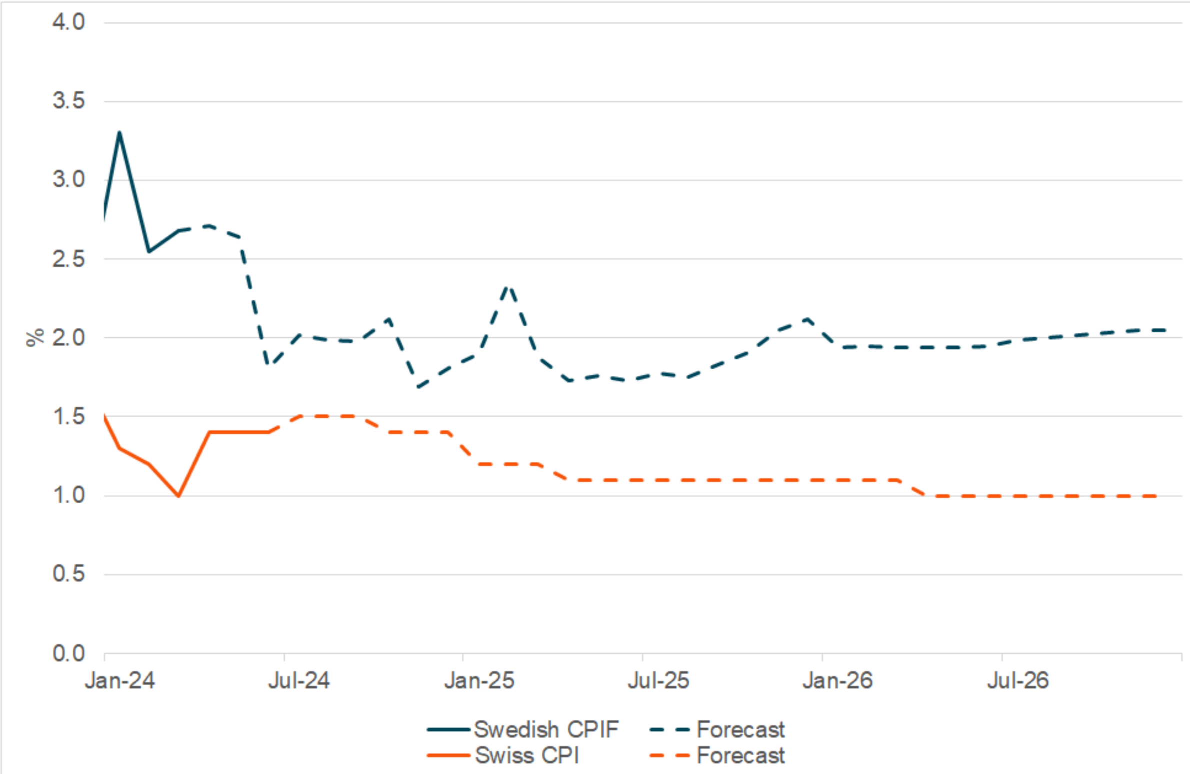


Source: Macrobond, BNY

The release calendar aside, data challenges may also have contributed to the lack of a Monetary Policy Report (MPR) in May, which normally would have accompanied the corresponding policy decision. Given the ongoing divergence between the two-year inflation outlook for Switzerland and the Eurozone, not just in terms of levels outright but also latest revisions, where Sweden stands will have a clear bearing on the policy outlook, as well.

Although last week's SNB decision was a close call, a small additional downward adjustment in its conditional inflation forecast – already at very low outright levels near 1% from 2025 onwards – was the clear justification for additional easing. In contrast, the ECB's latest staff projections had upward revisions for this year and next, but the annual percentage rate for HICP was only expected to fall to below the 2% target in 2026. Sweden's path, based on the March MPR, is expected to be somewhere in between the two (exhibit #2): inflation falling below target through the next 12 months before converging to 2%, but the general path from next year onwards is one of steady recovery. The spread between Swiss and Swedish inflation is expected to widen from less than 30bp in Q4 2024 to over 100bp in 2026.

Exhibit #2: Riksbank Inflation Forecast Differs From Peers



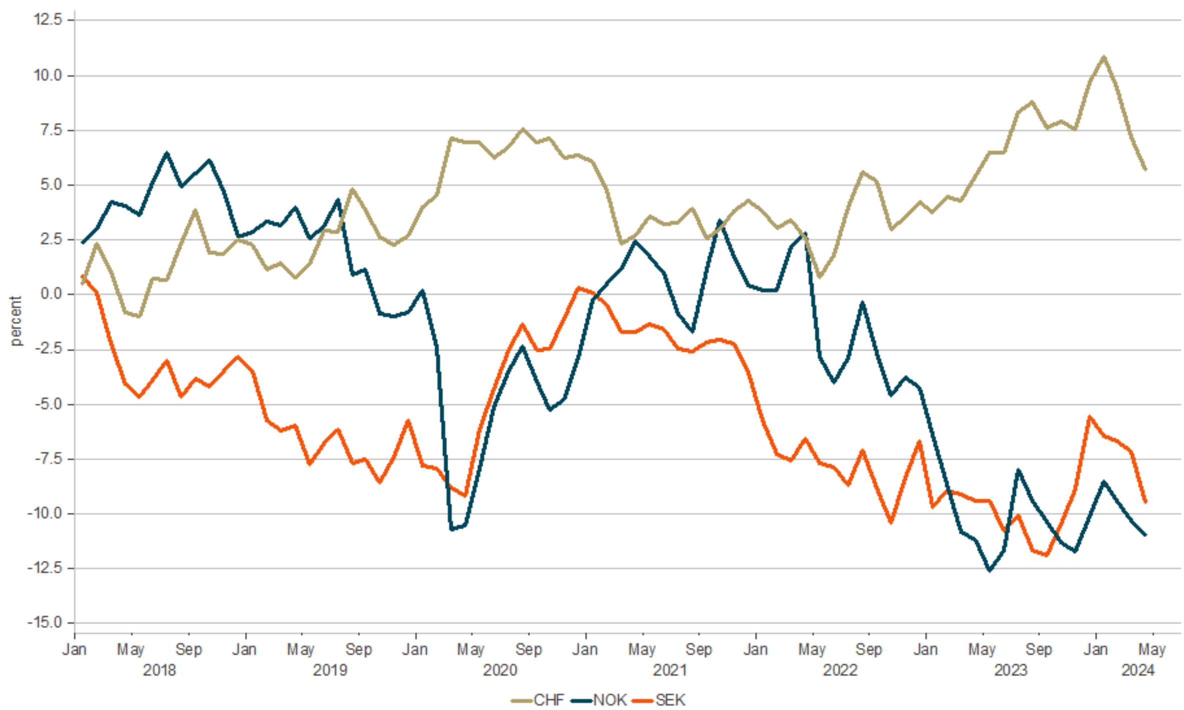
Source: Sveriges Riksbank, Swiss National Bank, BNY

Given similarities between the two economies – both manufacturing-based, enjoying twin surpluses and access to the EU labour market to mitigate supply risks – the divergence is considerable. Productivity differentials is a significant factor, but both central banks would likely point to developments in exchange rates as making the biggest difference.

The next Riksbank MPR will also contain expectations for the krona (via the KIX trade weighted import price index). Given the low starting point for the currency (-10% REER decline since 2021), we doubt the Riksbank will deviate much from its position that the krona remains a 'risk factor' (to the upside) for inflation. Furthermore, we believe that recent developments in Eurozone sovereign bond markets have also contributed to safety flows into the franc. While ex-Eurozone Nordic economies enjoy AAA status and their bond markets will likely perform strongly in any associated periods of risk aversion, we don't think the same could be said for their currencies. The Riksbank has cut rates extremely aggressively in the past in response to Eurozone sovereign stress, while liquidity challenges for SEK (and NOK) have also inhibited safety flow. As the ECB has recently affirmed (also confirmed in iFlow), we do not expect this theme to be a major driver for policy decisions. Even were the

Riksbank to introduce the matter as a key risk, disinflation pressures would likely arise from a severe demand external demand shock, rather than SEK strength.

Exhibit #3: SEK, NOK & CHF REER Changes



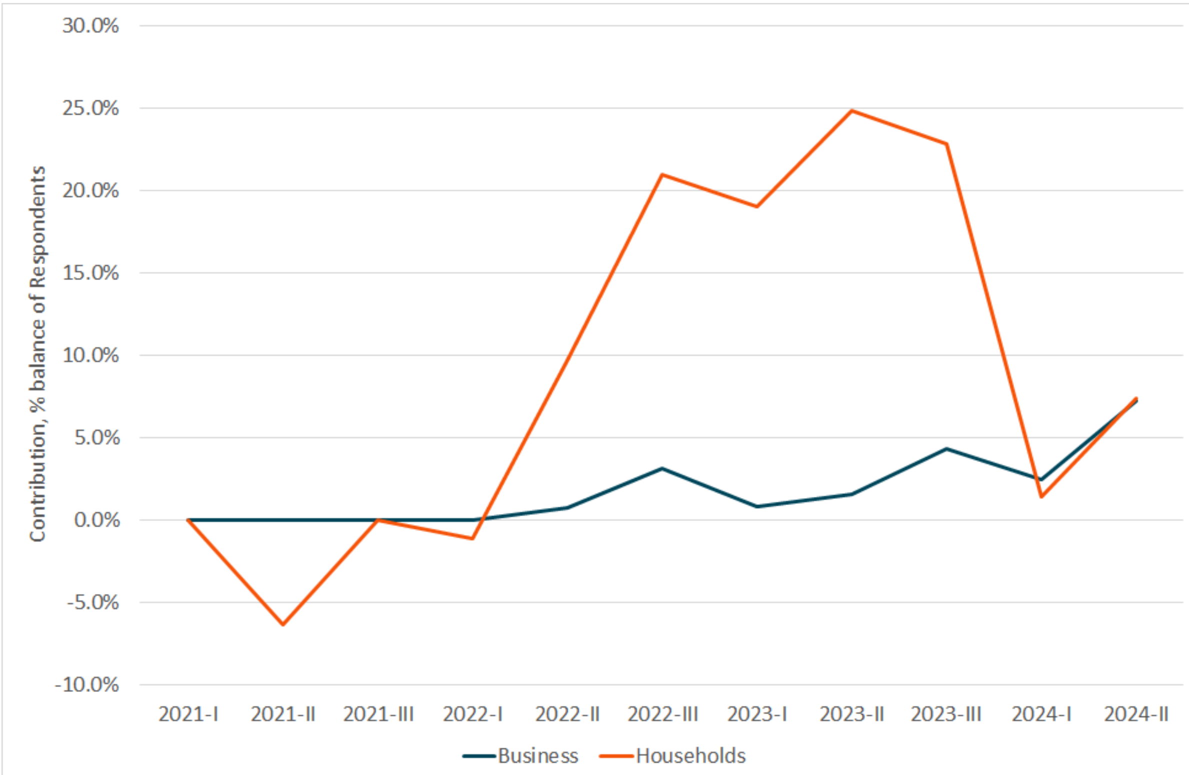
Source: Macrobond, BNY

Nonetheless, compared to last year the Riksbank's language on the krona has clearly softened. This means that the risk of a material delay in further easing due to SEK weakness is low. During the tightening cycle, krona valuations were seen as the biggest risk to inflation surprises, but we expressed our view at the time that the Riksbank was doing very little in the way of mitigation, with Governor Thedéen openly expressing scepticism at the ability of rate hikes or intervention to help strengthen the krona, though ultimately the Riksbank's FX hedging programme likely helped contain additional weakness.

More importantly, the Riksbank's assessment that inflation expectations are "firmly anchored" suggests the weak SEK is no longer exerting significant price push. This is supported by the latest Riksbank Business Survey for the retail sector. While opinions differ on the outlook and sales prices over the next 12 months have rebounded, the exchange rate as a factor behind rising prices has dropped sharply amongst respondents (exhibit #4). The response balances this year are a fraction of the levels seen through end-2022 and all of 2023, though we expect the Riksbank will maintain vigilance over its direction.

If severe pass-through risks flagged by business and households last year did not generate a direct Riksbank response, it is unlikely that this will occur now that risks are much lower, and it could cut without fear of stoking inflation risk through the exchange rate. The bigger challenge: the same survey shows downside price drivers remain elusive to justify a cut.

Exhibit #4: Exchange Rate Contribution To Price Outlook



Source: Sveriges Riksbank, responses from companies which sell to companies and households. BNY

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