

6/9: Riksbanken to slightly lower rate path

- **We expect Riksbanken to lower the rate path to signal slightly less chance of a December 2018 hike**
- **Weak underlying inflation and trade uncertainty call for caution; we still see a hike in February 2019**
- **High energy prices and weak SEK to lift inflation short-term, and we see a risk of an unchanged path**

Our expectations: We expect Riksbanken to keep the policy rate unchanged and slightly lower the rate path from July 2018 to indicate somewhat less probability of a December 2018 hike. In our view, one option could be to signal a smaller (than 25bp) hike in December 2018 (e.g. 10bp), which would also mean a slight downward revision of the rate path. Our forecast of a somewhat lower rate path is based on underlying inflation having continued to disappoint since July 2018, and we therefore expect the majority of the board (Mr Jansson, Mr Ingves and Mrs af Jochnick) to have reservations in giving a clear signal of a hike in December 2018. We believe an unchanged path would be such a clear signal, as the current path indicates almost 90% probability of a 25bp hike in December 2018, according to our calculations. Increasing uncertainty related to the US-China trade war also calls for caution, and we believe the first rate hike will be postponed until February 2019. However, we do not rule out an unchanged rate path, as the SEK is once again weaker than the Riksbank expected and higher than expected energy prices are likely to lift inflation in the short-term.

Current monetary policy: At the meeting on 3 July, the policy rate was kept unchanged at -0.50%. The rate path was also left unchanged, indicating a first rate hike in December 2018, but with some probability of the hike instead in October 2018 or February 2019. The verbal communication pointed towards December 2018. Vice Governor Henry Ohlsson entered a reservation against the rate decision and voted for a rate hike of 25bp to -0.25% (as he also did in February 2018 and April 2018). In addition, Vice Governor Martin Flodén voted for a rate path signalling an earlier rate hike (in Q3 2018). Mr Flodén and Mr Ohlsson also made reservations against the decision to extend the mandate for foreign exchange interventions.

News since the previous meeting

Inflation slightly higher than expected, but weak underlying inflation. Core inflation (annual growth in CPIF) was 2.22% in July 2018, versus Riksbanken's projection of 2.12% (from its monetary policy report published in July 2018). However, core inflation excluding energy, which the Riksbank has given increasing attention to, was below expectations at 1.29% (Riksbanken projected 1.44%). Hence, the upside surprise in CPIF was solely due to higher than expected energy prices. Besides, services price inflation continued to fall, and was down to 1.19% in July 2018.

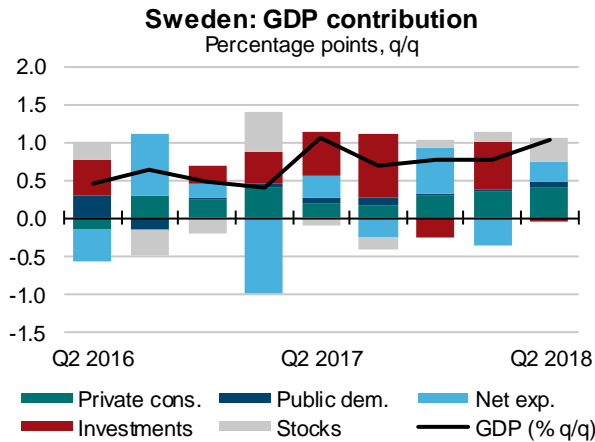
SEK remains weak, and weaker than expected. EURSEK remains at weak levels and is currently trading close to 10.70. The import weighted SEK is currently 120.5, which is 2.1% weaker than Riksbanken's Q3 projection. However, the average so far in Q3 is only 0.7% weaker than Riksbanken's projection.

GDP growth higher than expected, while unemployment a touch higher. GDP growth for Q2 was 4.2% QOQ annual rate, versus Riksbanken's expectation of 1.96%. We caution putting too much weight on these figures, as the Q2 reporting was earlier than normal due to the need for data material as a basis for the work with the fiscal budget. This reading is often subject to large revisions and we expect it to be revised down, as other indicators for the economy are pointing towards slower growth. Retail sales have also weakened lately, but could be affected by the warm, dry summer. Unemployment was in line with the Riksbank's forecast in Q2, but rose somewhat in July 2018 despite a solid rise in employment.

Housing market concerns still present, but abating. House prices (unadjusted) increased by 2.9% in the first seven months of 2018, and the trend seems to be stabilising somewhat. However, YOY growth has continued to decline, and was -4.9% in July 2018. There is still uncertainty regarding the effect of the new home mortgage regulations that came into effect on 1 March 2018, and we continue to see downside risk (albeit abating slightly) for housing prices. However, we do not expect Riksbanken to be very concerned about the housing market at this point.

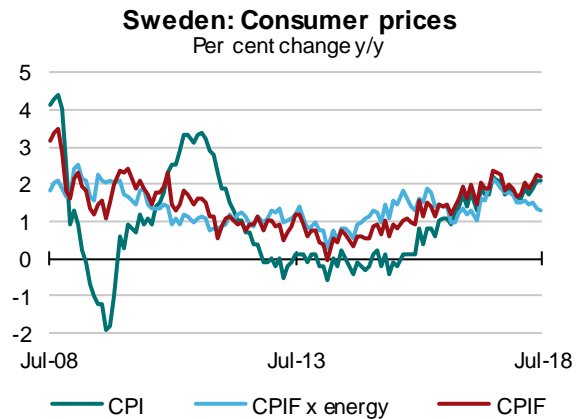
Foreign factors call for careful approach. The escalation of the US-China trade dispute and the potential effects for Europe also pose a downside risk for the Swedish economy, in our view. Furthermore, the ECB has signalled that it will not hike rates before summer 2019 at the earliest (we expect the first hike in September 2019). Riksbanken has a history of following ECB policy to a large extent, and we believe it is unlikely to hike rates much without the ECB also hiking, due to the risk of a rapid SEK appreciation.

High growth in Q2, but we could see revisions



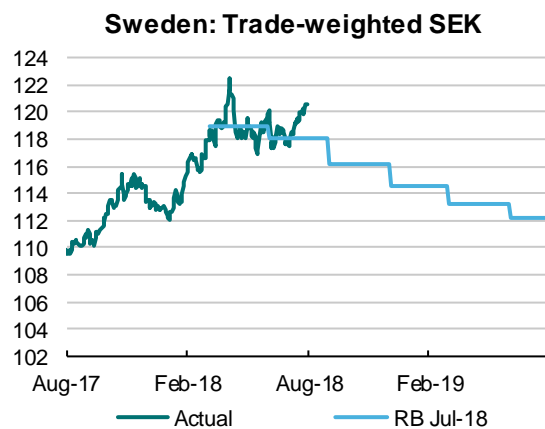
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Weak underlying inflation, CPIF lifted by energy prices



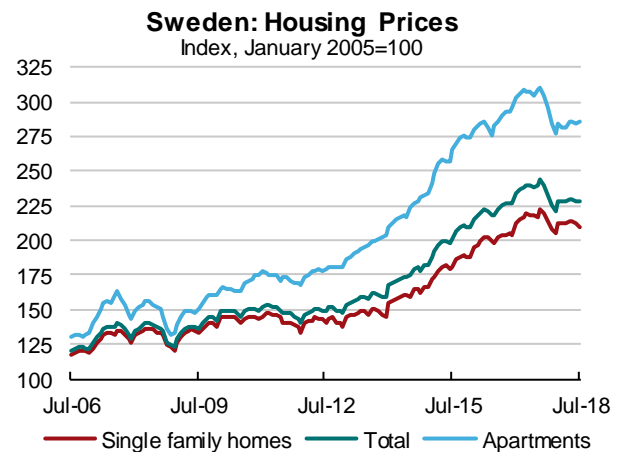
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SEK slightly weaker than Riksbanken expected



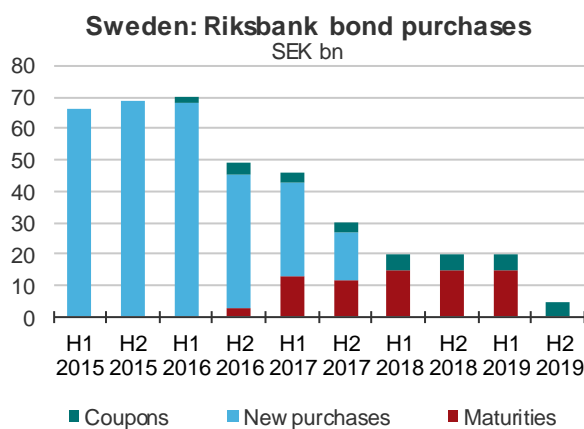
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Housing market concerns still present, but abating



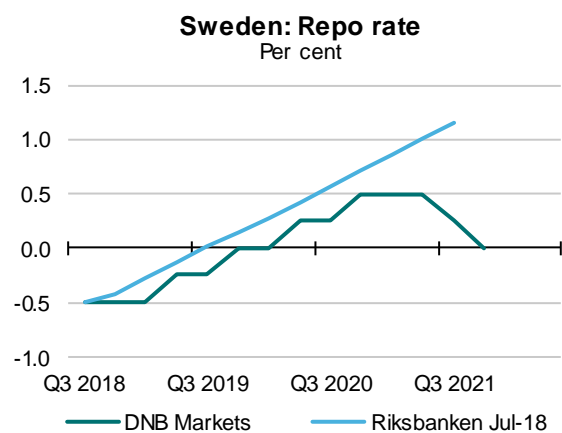
Source: Nasdaq OMX Valuequard/Thomson Datastream/DNB Markets

Riksbanken continues to expand balance sheet...



Source: Riksbanken/DNB Markets

...and hike could be postponed until February



Source: Riksbanken/Thomson Datastream/DNB Markets

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