Macro & FICC Research

SEK Views

Wednesday, 21 April 2021

You are neutral waiting for new drivers

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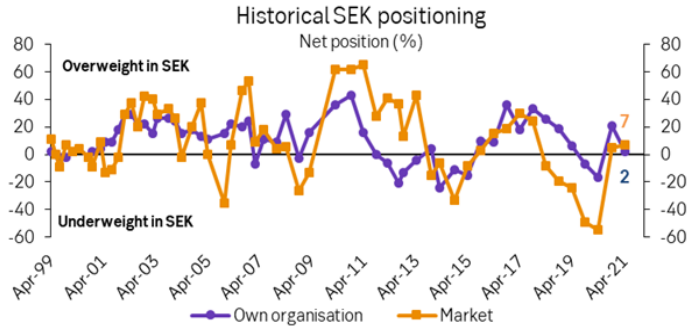
Our biannual survey of Financial Institutions and Corporates show the market has scaled-back their previous sizable overweight position in SEK reported in October 2020. The market is now neutral waiting for new drivers to present themselves where exports and risk appetite are seen as the most SEK positive factors.

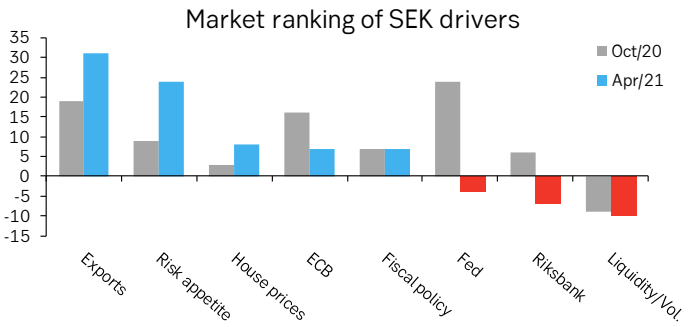
A large majority of the FX and FI survey respondents expect the Riksbank to be on hold in April. The majority still expect the next move to be a rate hike, but FX investors foresee somewhat earlier rate hikes. SEB expects Riksbank to taper its QE programme 2021 but then see unchanged policy for the foreseeable future. Should SEK continue to appreciate towards our estimated long-term fair value (9.65 vs the euro) we think Riksbank will cut the repo rate back into negative territory.

Despite negative flows from Riksbank buying FX and selling SEK in addition to the current dividend season we think the underlying flow picture is SEK supportive.

Neutral stance on SEK but growth outlook, flows and valuation are positive drivers going forward

SEK Views is our biannual flagship report on Swedish macro developments, Riksbank monetary policy, the FX market outlook including also ad hoc research on relevant topics. As usual this report contains our FX survey of the biggest FX trading counterparties in Sweden, asking them on their positioning, SEK forecasts, Riksbank expectations etc. Having been very constructive on SEK in 2020 we moved to be neutral at the start of 2021 expecting sideways trading in EUR/SEK but with a small upward tilt during the ongoing equity dividend season. EUR/SEK did trade higher for a brief period in early April but fell back quickly as the USD weakened and US yields came lower. We think the USD outlook constitutes a major if not the major role for SEK developments (on a trade-weighted basis). Apart from USD developments the outlook is now positive on flows, valuation and cyclical outlook.





Content

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Trades ideas & Recommendations

- Sell Mar22 SEK FRA and pay 5s10s curve with Sep IMM start.
  - Risks in the front FRAs are skewed lower, with practically no risk of a rate cut priced in. The long SEK rates are driven by international rates (mostly US) and the reflation theme. We expect US rates to stabilise during Q2, but we expect the Fed tapering announcement during the summer, which is likely to put renewed upside pressure on long rates, which is likely steepen the long-end of the SEK curve as well.
- Sell EUR/SEK at 10.25 targeting 9.80, stop loss above 10.40 on a daily close.
- Alternatively look to buy rangebet in EUR/SEK (see also Currency strategy from jan 2021) 9.95/10.35.
- Buy NOK/SEK targeting 1.04, stop loss below 1.00 on a daily close.
- Sell GBP/SEK at 12.00 targeting 11.25, stop loss above 12.15 on a daily close.

FX forecasts

		FORECASTS							
FX	***4/21/2021***	**1M**	**Q2 21**	**Q3 21**	**Q4 21**	**Q1 22**	**Q2 22**	**Q3 22**	**Q4 22**
EUR/USD	*1.200*	1.20	1.22	1.20	1.18	1.16	1.15	1.14	1.13
EUR/SEK	*10.16*	10.25	10.15	10.05	9.90	9.80	9.75	9.70	9.70
EUR/NOK	*10.05*	10.00	9.90	9.85	9.80	9.75	9.80	9.85	9.85
EUR/CHF	*1.101*	1.09	1.11	1.11	1.12	1.12	1.13	1.13	1.14
USD/JPY	*108.2*	108	106	105	104	105	106	107	108
USD/CAD	*1.260*	1.24	1.23	1.24	1.25	1.26	1.26	1.26	1.26
EUR/GBP	*0.862*	0.85	0.84	0.83	0.84	0.85	0.86	0.86	0.87
AUD/USD	*0.771*	0.77	0.78	0.80	0.82	0.82	0.82	0.82	0.82
NZD/USD	*0.717*	0.72	0.73	0.75	0.77	0.77	0.77	0.77	0.77
USD/SEK	*8.463*	8.54	8.32	8.38	8.39	8.45	8.48	8.51	8.58
GBP/SEK	*11.781*	12.06	12.08	12.11	11.79	11.53	11.34	11.28	11.15
NOK/SEK	*1.011*	1.03	1.03	1.02	1.01	1.01	0.99	0.98	0.98
JPY/SEK	*7.83*	7.91	7.85	7.98	8.07	8.05	8.00	7.95	7.95
CAD/SEK	*6.72*	6.89	6.76	6.75	6.71	6.70	6.73	6.75	6.81
AUD/SEK	*6.53*	6.58	6.49	6.70	6.88	6.93	6.95	6.98	7.04
CNY/SEK	*1.30*	*1.32*	*1.29*	*1.32*	*1.35*	*1.37*	*1.39*	*1.41*	*1.43*
CHF/SEK	*9.22*	9.40	9.14	9.05	8.84	8.75	8.63	8.58	8.51
USD/NOK	*8.37*	8.33	8.11	8.21	8.31	8.41	8.52	8.64	8.72
GBP/USD	*1.392*	1.412	1.452	1.446	1.405	1.365	1.337	1.326	1.299
EUR/JPY	*129.8*	129.6	129.3	126.0	122.7	121.8	121.9	122.0	122.0

Macro & FICC Research

Riksbank survey

Wednesday, April 21, 2021

Unchanged in April, split between FI and FX investors further out

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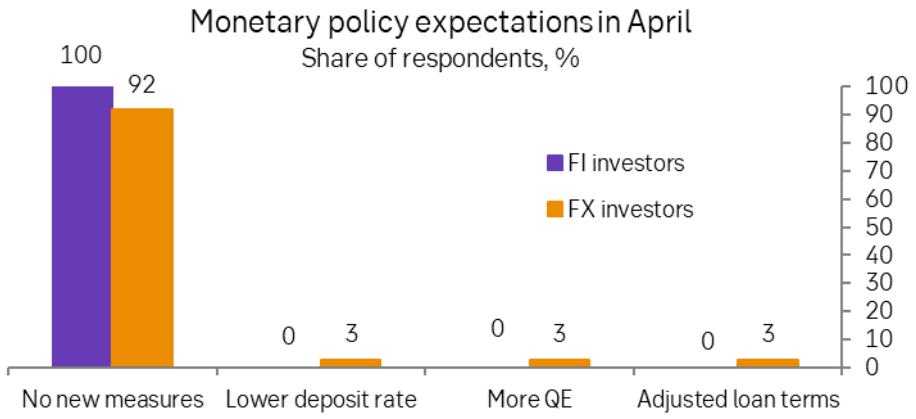
According to our investor survey among Fixed income and FX investors, a large majority of respondents expect the Riksbank to be on hold in April. The majority still expect the next move to be a rate hike, but there is a split between the FI and FX investors, where FX in general foresee somewhat earlier rate hikes and fewer believe in rate cuts. On the other hand, almost half of the FX investors think the QE programme will be extended beyond 2021, while only 20% of the FI investors expect an extension. Most participants say that inflation will have to deviate significantly from the Riksbank's forecast before causing any policy actions. Around half of the respondents are concerned about an overheating of the US economy but very few see such a risk in Sweden. Since the February survey, FI investors have increased their positioning for higher rates and a steeper curve, while claiming to be more neutral positioned in inflation-linked bonds and fewer say to be positioned for tighter covered bond spreads.

Large majority expect unchanged policy in April

Ahead of Riksbank's rate decision on 27 April, we have asked the largest Swedish Fixed Income and FX investors about their expectations on monetary policy, the outlook and positioning.

According to our survey, a large majority of respondents expect the Riksbank to keep all its parameters unchanged at the April meeting. Among the FI investors no one expects any changes, while a few of the FX investors expect the Riksbank to change the deposit rate, QE programme or loan terms to banks. The majority (82%) expect the rate path to predict that the repo rate will remain at zero until the end of the forecast period in Q2 2024. The forecasting horizon will be extended by one quarter in April. Among the remainder, 15% predict the path to show a probability of a rate hike, while 3% believe the path will indicate a rate cut.

All most all participants expect unchanged policy in April



Fewer FX investors believe in a rate cut but a larger share expect more QE

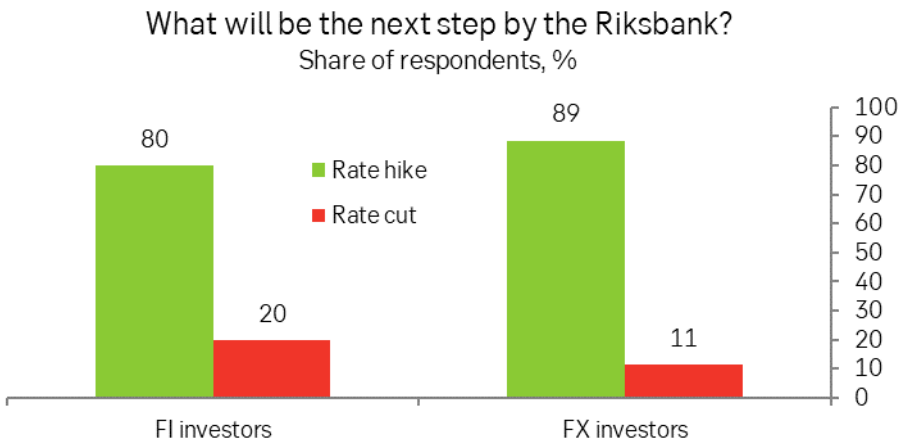
Regarding the actual policy rate, a majority continue to expect the next move to be a rate hike. However, there is a difference between the FI and FX investors, where the FX investors in general expect earlier rate hikes (37% before end-2022) and fewer believes in rate cuts (11%). Among the FI investors, 20% still foresee a rate cut before the end of Q2 2022 while only 12% expect a rate hike before end-2022. Comparing with our last survey among the FI investors, expectations for a rate cut have declined slightly (from 26% in February) but expectations of a rate hike have at the same time been postponed. Interestingly this has not been reflected in market pricing, where the jag

har probability of a rate cut is largely unchanged compared to early February (around 3-4bps) while the pricing for a rate hike further ahead have clearly increased. The market is now pricing some probability of a rate hike already in 2022 (8bps by the end of 2022) and a full 25bps rate hike by Q3-2023.

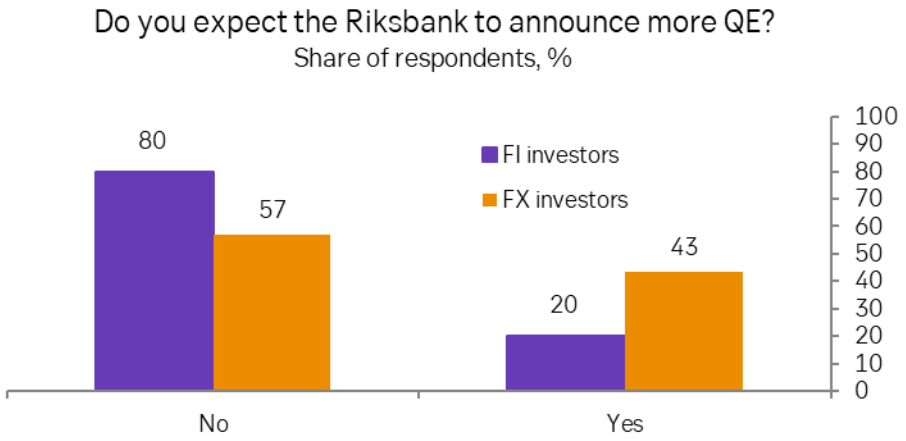
Another interesting result is a large split regarding the expectations for the QE programme between the FI and FX investors, where the FX investors are clearly more dovish. While only 20% of the FI investors believe the Riksbank will extend the QE programme beyond the end of this year, as many as 43% of the FX investors believe the Riksbank will announce more QE. In our view, the large divergence between the investor groups is probably partly explained by an increased discussion among FI investors of the purpose and need for more QE given the already very tight credit spreads and deteriorating functioning of the Swedish bond market. The covered bonds is perceived to function less well because of the Riksbank's QE purchases (see the Riksbank's Financial Markets survey here).

Our own expectations are that the Riksbank will present details of its QE programme for Q3 in the April Monetary Policy Report (MPR). So far, the board has chosen to frontload bond purchases by buying SEK 120bn in Q1 and SEK 100bn in Q2 but according to the forecast in February, the Riksbank will buy only SEK 72bn per quarter in Q3 and Q4. Only FI investors were surveyed about the details of the QE programme and a large majority (88%) expect the Riksbank to keep the forecast for total purchases in coming quarters unchanged and 92% expect the split between assets to be unchanged.

FX investors in general expect earlier rate hikes and fewer believes in rate cuts



FX investors clearly more dovish regarding more QE than the FI investors

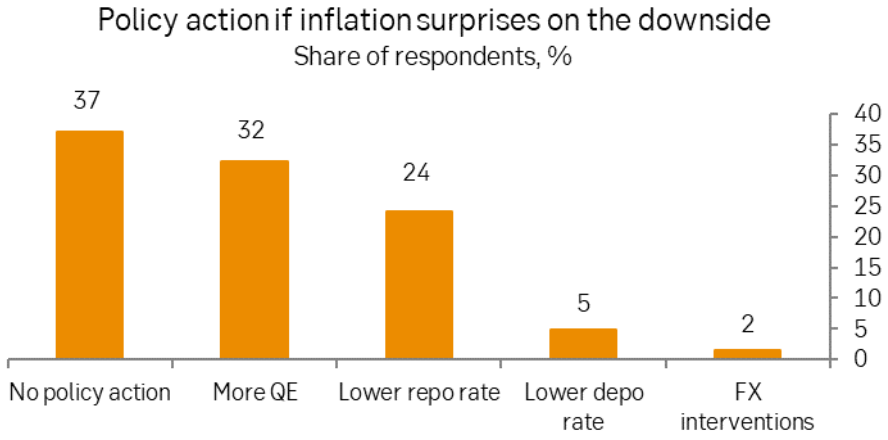


Large downside surprises in inflation needed for policy action

After being 0.5pp lower in February, CPIF inflation returned to the Riksbank's forecast in March at 1.9%. Both we and the Riksbank expect inflation to continue to increase in April but predict the inflation rate to turn lower again during the summer. According to the Riksbank's forecasts in February, CPIF is expected to decline to 1.2% by the end of this year and CPIF ex. energy to fall to 0.9%. To assess how sensitive the Riksbank will be to deviations to this forecast, we asked participants in the survey how much they think that underlying inflation (CPIF ex. energy) needs to deviate from the Riksbank's forecast before triggering any policy reactions. According to the survey,

underlying inflation will have to deviate quite significantly before it will cause any policy actions, with FI investors indicating 0.6%-points and FX investors 0.8%-points is needed. In such a scenario, an extension of the QE programme is still most probable (32%), followed by a rate cut (24%). Still, 37% expect that the Riksbank will continue to look through lower inflation and not present any new policy measures even with markedly lower inflation.

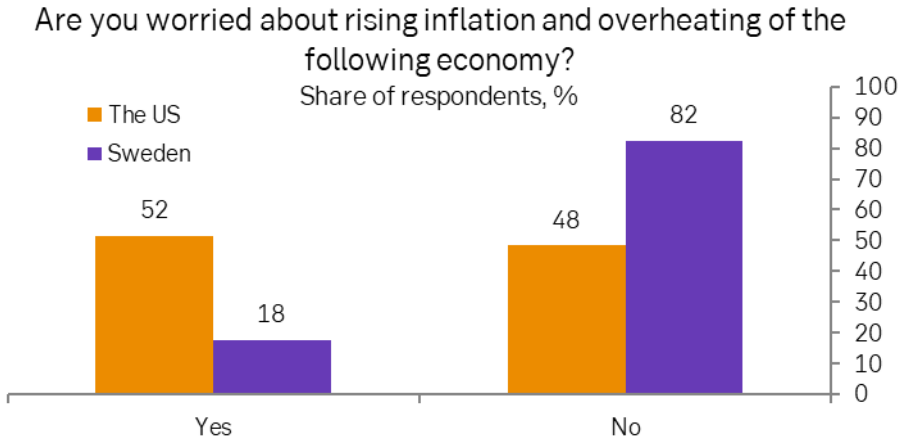
Large downside surprises in inflation before causing any policy action, rate cut most likely then



Room for more fiscal policy and small risk for overheating in Sweden

Large US fiscal stimulus and a strong economic recovery once restrictions are lifted have increased speculation of an overheating of the US economy, which has pushed yields clearly higher this year. For 2021, we expect US discretionary fiscal stimulus to amount to approximately 6.5% of GDP. The corresponding figure for Sweden is approximately 2.5% of GDP. According to our survey, a small majority (52%) think the Swedish government should present more fiscal stimulus, while 38% do not think this would be a good idea and 10% do not have a clear opinion. However, while investors are split about the risk of rising inflation and an overheating of the US economy, a clear majority (82%) do not see such a risk for the Swedish economy.

Half of the respondents worried about an overheating in the US, very few see such risk in Sweden



Increased positioning for higher rates and a steeper curve

The average investor in the fixed income market continues to be short in duration (positioned for higher rates) confirming the shift in the February survey. The duration score has declined and is now clearly below the average since the survey started in 2004 (-0.52 vs. average -0.15). Positioning for a steeper curve has also continued to increase to 64% of the respondents, which is the largest share since 2013. In line with the last two surveys, no respondent has claimed to be positioned for a flatter curve. For the first time we have also asked investors about their positioning in inflation-linked bonds. Here the positioning is more neutral but with a small tilt towards higher real rates with an average score of -0.18.

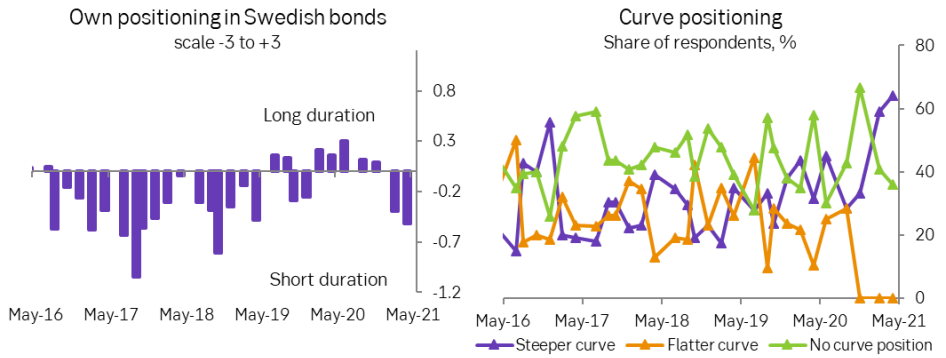
The Riksbank's QE programme has clearly supported the covered bond market and a 5y covered rate vs swaps is now trading close to zero compared to around 20bps before the pandemic. However, positioning in covered bonds continues to gradually decline from the peak in April last year. At that time 64% of the respondents were positioned for tighter spreads, but the share has now declined to 44%, marginally down from 48% in the survey in February. Still, only 4% claim to be positioned for a

wider spread with the remainder positioned for an unchanged spread. However, when asked in which range a 5y covered bond spread will trade during 2021, risks seem to be tilted somewhat to the upside with the investors on average foreseeing a lower bound at -6bps and a upper bound at +9bps in.

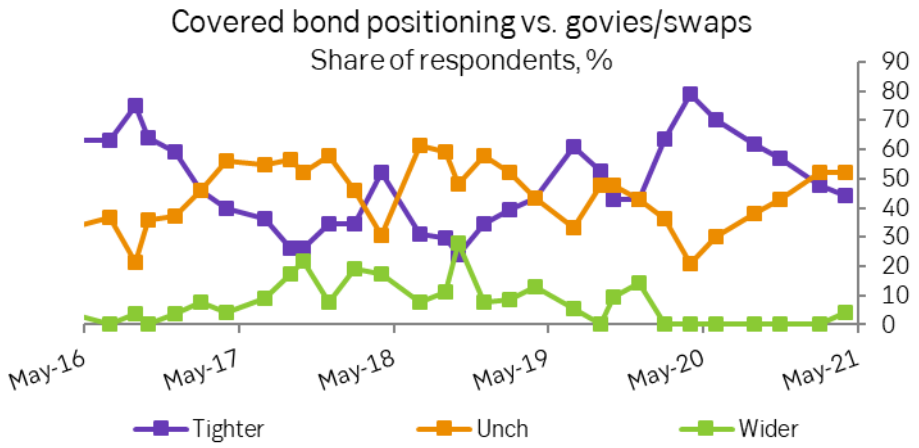
A final question to our FI investors is if they expect any changes in the Riksbank's certificates this year. The share of total liquidity that the Riksbank withdraws from the banking system by certificates has clearly declined since the large QE expansion started last year and the excess liquidity that is being left in the system has increased by more than 400bn since February last year. This has contributed to push the 3m stibor clearly lower. However, a large majority (92%) do not foresee any changes in volumes during 2021 and the few expecting any changes are evenly split between lower and higher volumes.

Regarding positioning in the FX market please see a separate article here.

Increased positioning for higher rates and a steeper curve



Positioning in covered bonds continues to gradually decline from the peak last spring



Note: The survey was conducted among around 25 Swedish FI investors and 40 FX investors between 12-15 April

Macro & FICC Research

Riksbank policy outlook

Wednesday, April 21, 2021

Stronger krona still most probable trigger for a rate cut

Although inflation is expected to run below target until the beginning of 2024 the Riksbank does not seem to have come close to a rate cut and the board's tolerance for low inflation is significantly higher now than it was a few years ago. Still, most board members indicate that a rate cut is still possible if the credibility in the inflation target is threatened and in our view a krona strengthening of another 5-6% would push inflation sufficiently low and trigger a rate cut of 50bps in 2022.

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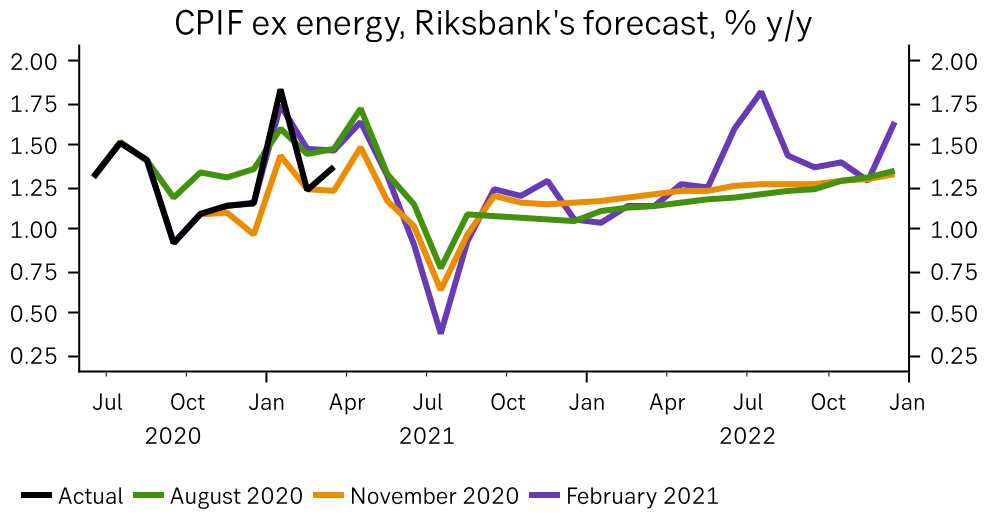
Low inflation could still trigger a rate cut

Although CPIF is expected to run well below the 2% target for a considerable period, the Riksbank's rate path does not signal any probability for a rate cut or any bias for the direction of the next move for the repo rate. The board does, however, indicate a downside bias verbally by saying in the press release that "It is also entirely possible to cut the repo rate, particularly if confidence in the inflation target were under threat". In the latest Minutes, all board members also say that lower inflation would warrant a policy response, but higher inflation would not, and that overshooting the inflation target for a period would be desirable. Our forecast continues to be that the repo rate will remain unchanged for the foreseeable future, but we continue to believe that near term risks for the repo rate are skewed to the downside and that inflation declining significantly more that the Riksbank's forecast indicates could make the board deliver a rate cut.

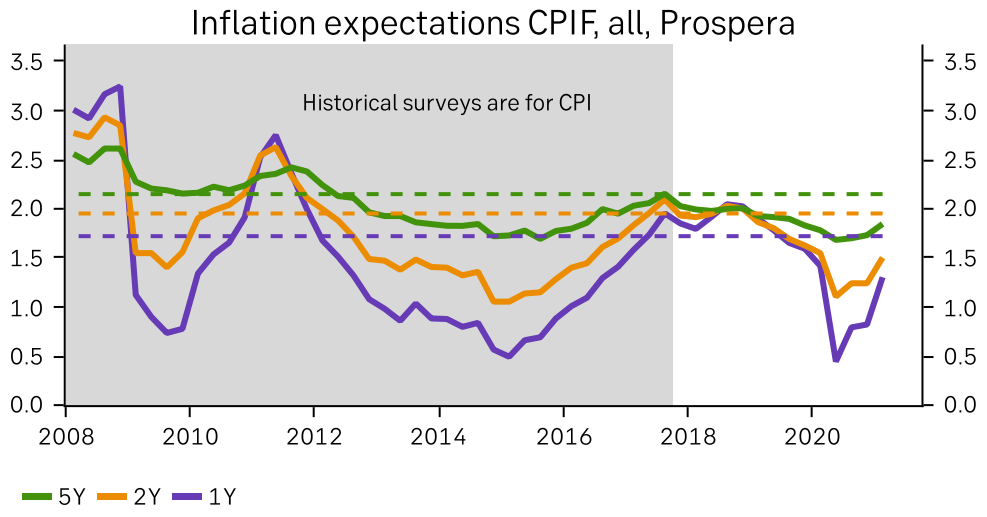
Guidance on how large the downside surprises need to be can be illustrated by the chart below. Actual inflation has occasionally been 0.2-0.3pp below the Riksbank's estimate over the last six to nine months without triggering any signals that rates could be cut. Support from slightly rising inflation expectations and better than predicted growth may have contributed, but compared with the situation a few years ago the board's tolerance for disappointing inflation has increased considerably (the board did, however, prolong and expand the QE programme in November when inflation deviated the most from expectations).

Inflation expected to be clearly below the target



Source: Central Bank of Sweden (Riksbanken), Statistics Sweden (SCB), Macrobond, SEB

Long-term inflation expectations at or below the lows since 2015

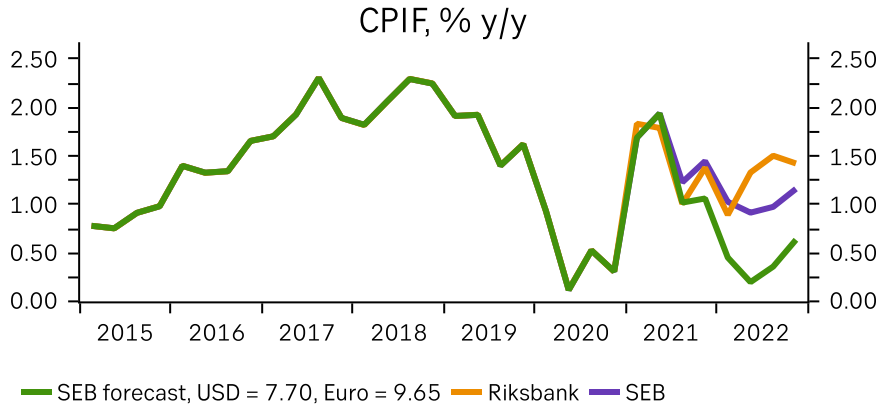


Source: TNS Prospera, Macrobond, SEB

Inflation below 0.5% likely to trigger a rate cut

Even though we predict that inflation will be slightly below the Riksbank''s forecast over the next 12-18 months we do not think the deviation is significantly large to trigger a cut. However, in a scenario with inflation more clearly declining below 1% and staying there for some time, the probability of a rate cut would rise significantly. A not unlikely driver for pushing inflation to these levels is a stronger SEK. If the krona in the second half of this year was to strengthen to EUR/SEK 9.65 and USD/SEK 7.70, CPIF would according to our model decline to or below 0.5% y/y next year. In our view this is a reasonable scenario that would result in the Riksbank cutting rates to -0.50 again in 2022. The analysis implies that relatively large movements for the SEK is needed towards 9.65/7.70 which are also our estimates for the long-term fair value for the krona against the euro and the dollar. However, in a scenario with a strong global recovery it is possible that the SEK could reach these levels. In terms of the KIX-index, 9.65/7.70 corresponds to a level around 107.5, which would be 5-6% stronger than the current level of 113.5. **Hence, in our view would another 5-6% strengthening of the SEK would push inflation sufficiently low to trigger a rate cut of 50bps in 2022.**

Significant strengthening of the SEK likely to cause rate cuts at a later stage



Source: Central Bank of Sweden (Riksbanken), Macrobond, SEB

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SEK Views FX survey

Wednesday, April 21, 2021

You are neutral waiting for directions

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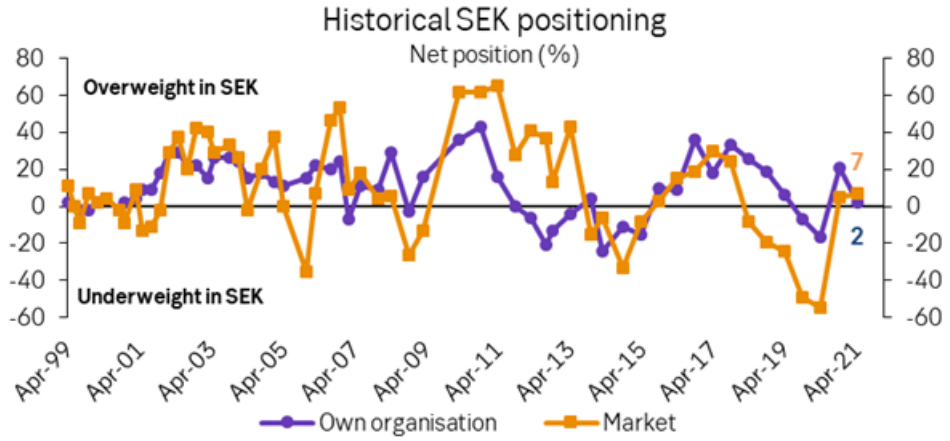
Our survey of leading SEK trading Corporates and Institutions reveals a more muted change in krona positioning and sentiment compared to the marked turnaround in the report six months ago. Survey participants' own positioning in SEK is perceived as quite neutral while the market is still expected to be slightly overweighted. Financial institutions have moved from a near record-long to almost neutral krona positioning. The Fed- and the Riksbank policy outlook are now seen as negative drivers while exports is perceived as the most positive SEK driver. Survey participant project a modest SEK appreciation in the months ahead. Both corporates and institutions have slightly increased their hedge ratios and plan to continue doing so, which should add some support to SEK. The NOK is expected to outperform in the coming six months. The overall conclusion from the survey is that the market is rather neutral and cautious waiting for the next driver to present itself. You find the results from the client survey on Riksbank outlook etc here.

SEK Views survey on client positioning



Neutral positioning after the record-fast turnaround last autumn. Our bi-annual survey of the leading SEK trading corporates and institutions shows relatively small changes after the huge turnaround in the sentiment and positioning in the report from October 2020. Survey participants' own net positioning has fallen back somewhat from +21% to a rather neutral +2%. As regards the market positioning, the respondents perceive the developments to now be slightly more overweight SEK, but at a net balance of +7% it is far from a substantial position or strong sentiment that is indicated.

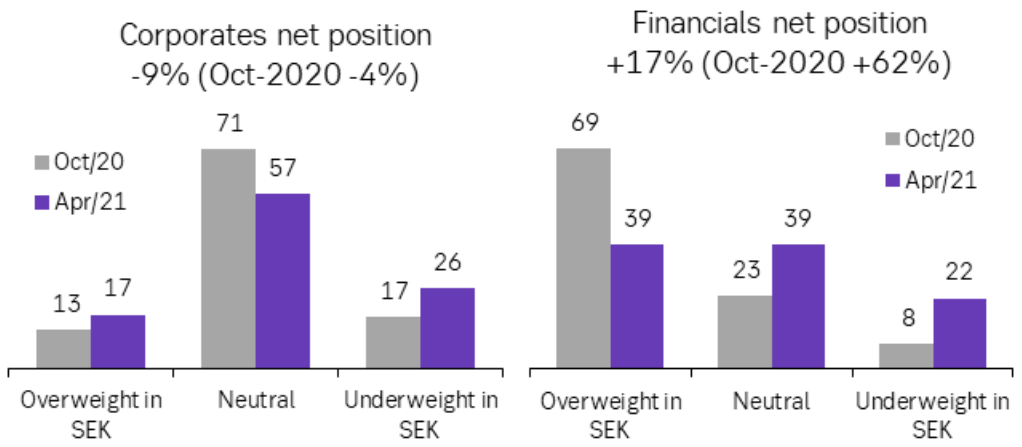
The sharp change in sentiment amongst our survey participants in October came after SEK strengthened significantly after the first part of the Covid-19 pandemic. SEK remained strong in November and December, but the environment became less SEK positive after the turn of the year. In 2021, the EUR/SEK downtrend from 2020 was replaced by EUR/SEK trading mostly sideways (in a range between 10.02/10.30) and therefore the smaller overweight in this survey seems natural.

As usual, the largest change in positioning was reported by financial institutions. The record large SEK overweight in October 2020 (+62%) is now significantly smaller (+17%). We believe that the major driver for the strong SEK in 2020 was increased dollar hedging among financial institutions which the sharp shift to an overweight SEK position supported. Likewise, the downscaling of the record large SEK overweight seen in this report should be one major reason for the sideways trend seen in SEK in 2021. In this perspective, the answers to two other questions in this survey are of

extra interest: (1) on key SEK drivers, exports are seen as the most positive driver, and (2) in questions on hedging, there is a slight overweight of financial institutions planning to increase their hedging ratios. **Thus, it seems that more normal drivers are expected to support the SEK going forward where exports will fuel growth**, something we agree on, but, also, that there may be another round of hedging-related SEK buying which could add to the SEK strength.

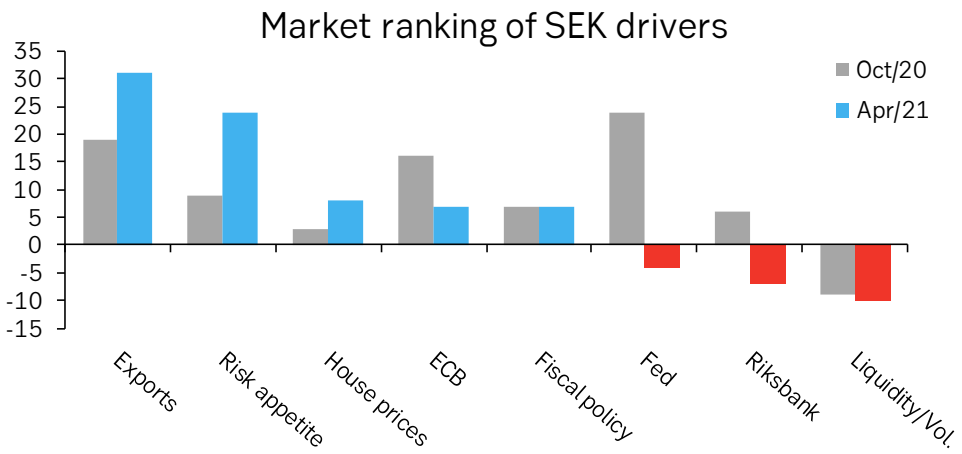
The perception of the market positioning does not vary much between Corporates and Institutions.

Survey participants SEK positioning



SEK drivers: positive but less so now. The market perception of SEK drivers has changed though they remain mostly positive. The view of the Fed has changed most dramatically: from being the most positive SEK driver, as their easing was very positive for the SEK in the spring and autumn, to being one of three negative SEK drivers. However, this not surprising given the recent focus on rising long-term US yields and possibilities of tapering in the autumn. Also, the Riksbank is now viewed as a negative driver for SEK which seems natural to us given its renewed attention to negative rates as well as signal value/timing of the restructuring of the FX reserve. Exports goes from the second largest positive to the most positive SEK driver, closely followed by risk appetite. With vaccinations providing hope for normalization of the Covid situation and thus a pick-up in growth, we share the belief that exports and increased risk appetite will support SEK in the coming months.

Survey participants ranking of SEK drivers



SEK appreciation expected. When it comes to the anticipated developments for SEK, the market expects, just as in October 2020, a gradually stronger SEK primarily against the USD but also vs. the EUR. For EUR/SEK we expect a similar decline towards Q2 but a bit faster after that targeting EUR/SEK at 9.90 in Q4. The implicit EUR/USD forecast made by the respondents holds EUR/USD at 1.20 in Q2 and 1.22 in Q4. Looking at the survey participants' views on long-term fair values for SEK, the median among respondents is an unchanged equilibrium rate at 8.00 for USD/SEK. For EUR/SEK, on the other hand, the equilibrium rate continues to fall and is now 9.70 compared to 9.75 in the previous survey and 9.95 one year ago. Our own equilibrium rate model SEB LTFV is now indicating EUR/SEK at 9.78 and USD/SEK fair value at 7.58.

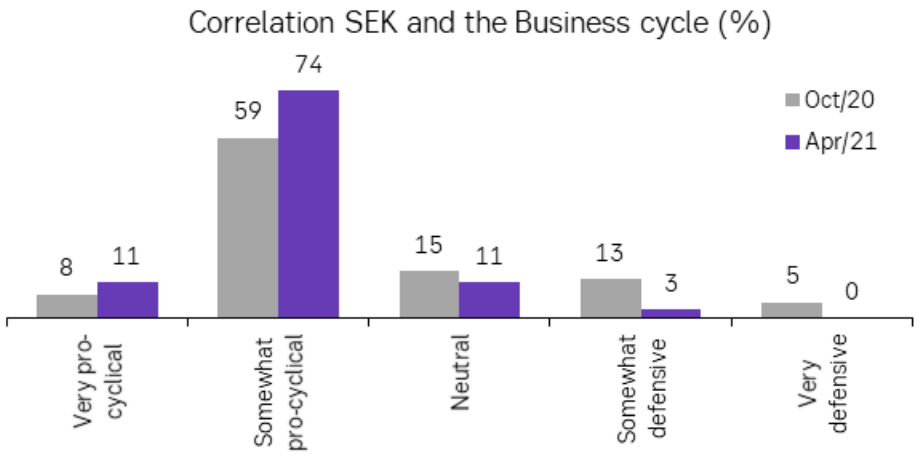
Survey participants FX forecasts

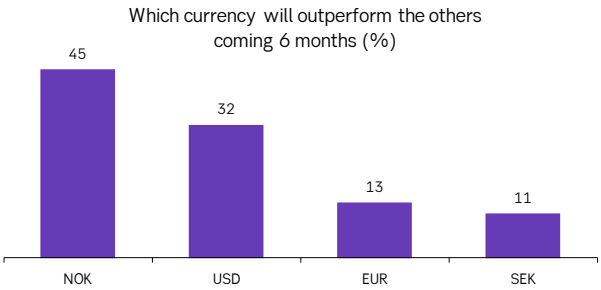
	EUR/SEK Jun-21	EUR/SEK Dec-21	USD/SEK Jun-21	USD/SEK Dec-21
Average	10.12	10.06	8.49	8.30
Median	**10.10**	**10.00**	**8.43**	**8.23**
High	10.40	10.50	10.25	9.00
Low	9.85	9.70	7.90	7.80

Average during survey EUR/SEK 10.16, USD/SEK 8.50, EUR/USD 1.20
Implied EUR/USD forecast Jun-21: 1.20 and Dec-21: 1.22

Back to old drivers: SEK is judged to be pro-cyclical. For some time now we have asked the survey participants about their view on the correlation between SEK and the business cycle. In 2020, a record-steep fall for the global economy was combined with a trade-weighted SEK that appreciated by more than 7%. During 2021, the recovery has continued but SEK has started to weaken, hence the pattern is not obvious. In this survey, 85% of participants remain with the view that the krona is indeed a pro-cyclical currency, meaning the market is back seeing SEK as a very risk-on and risk-off currency. As we have stated before, the fact that the market holds SEK as a pro-cyclical currency will also have an impact on how both domestic and international corporates and investors adjust their SEK/FX hedges. When asked which currency will outperform the other, it is interesting to see NOK at the top of the league table, indicative of the anticipated rate hikes by Norges Bank as a clear source for further anticipated currency strength.

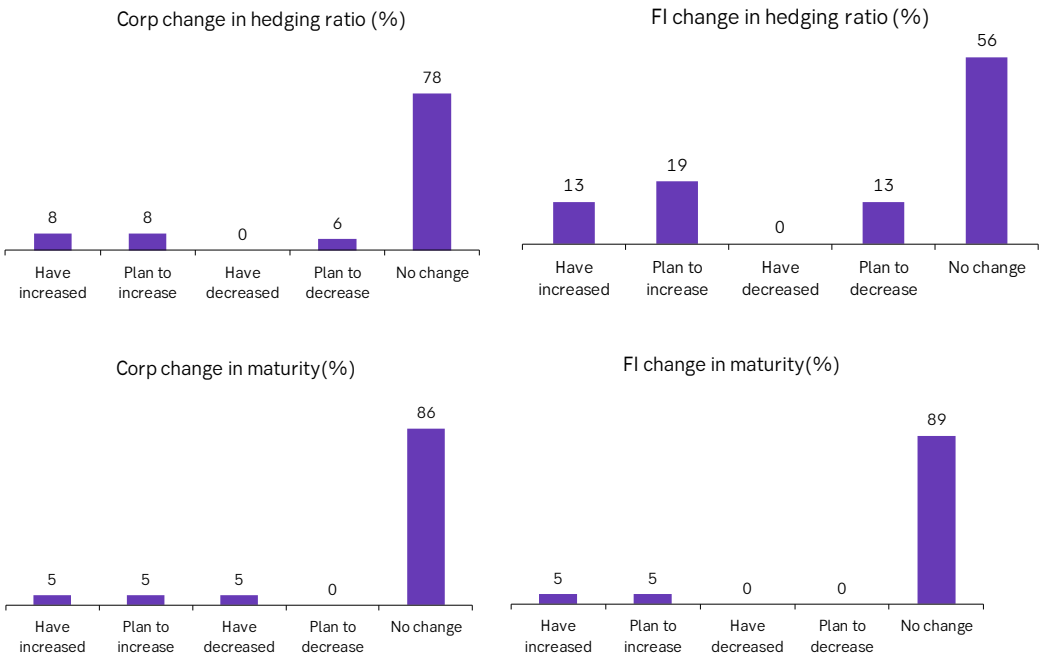
Survey participants view on SEK and correlation to business cycle





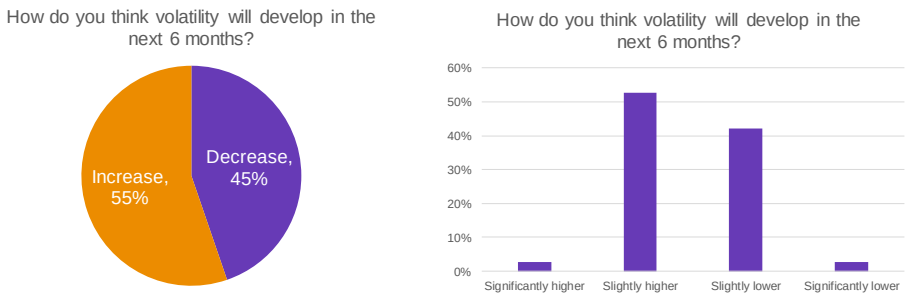
Hedging could increase some more. When it comes to hedging it seems that the largest changes, as well as plans for changes in the future, are among the financial institutions. 13% of them have increased their hedge ratios since the previous report and none has decreased their hedge ratios. We believe such increases of hedge ratios to be a major factor for the strong SEK last year (as hedging for our financial institutions implies SEK buying). There is still a small net balance (+6%) with plans to increase their hedging ratios, which is an implication of SEK support also this year from changed hedging policies.

Survey participants view on FX hedging



Volatility. A slight majority of 55% believes that EUR/SEK volatility will rise in the coming six months. However, only 3% of all respondents expects a significant increase, which is the same ratio expecting a significant decrease. The clearest take-away is that a massive majority of 95% expects only small moves in the coming six months.

Survey participants view on FX volatility



Macro & FICC Research

SEK Flow analysis

Wednesday, April 21, 2021

Supportive flow outlook/valuation promotes SEK appreciation

In every SEK Views report we look further into the development of the underlying FX flows driving the exchange rate. In the last report in October 2020 we concluded that the external developments are SEK positive, and they remain so. In this report we can also conclude that global growth developments are SEK positive and the FX survey participants expect exports to be the most positive SEK driver. At the start of the year the Riksbank sent a dovish signal as they have decided to sell SEK and buy FX in order to amortise FX denominated debt. The normal SEK seasonality is also negative in April/early May as companies distribute equity dividends. But despite negative Riksbank flows and dividends the underlying flow picture remains SEK supportive.

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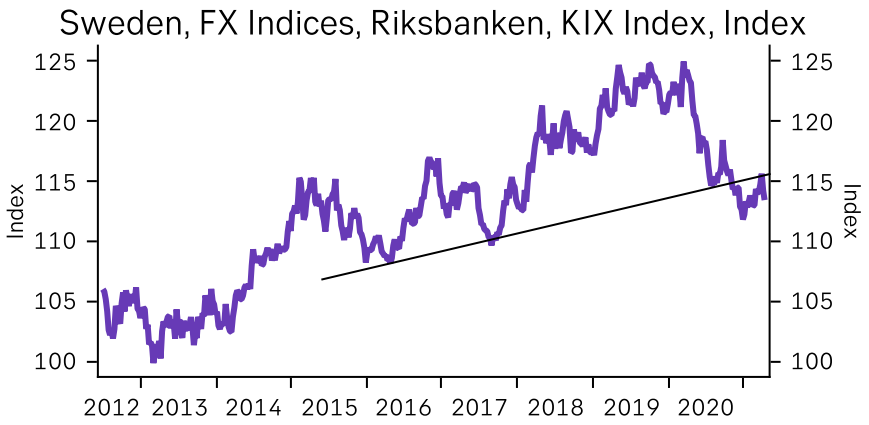
Trade-weighted SEK has appreciated despite adverse global growth in 2020



Source: Central Bank of Sweden (Riksbanken), Macrobond, SEB

Trade-weighted SEK: outperformance in 2020 but weaker this year

Starting with the most recent SEK development, 2020 was a clear turnaround year for the SEK and likely also changed many people's perceptions of how SEK normally develops (being previously categorized as a pro-cycling currency). There are many reasons why SEK was the top performing G10 currency 2020 (a year when global growth collapsed): primarily the rapid cuts in US interest rates drove down the attractiveness of the USD and as Swedish asset managers were overweighted USDs they had to sell of USD/SEK pushing the trade-weighted SEK higher. At the start of 2021, the market was caught very short USDs and, at a time when US fiscal policy was finally taken in another very expansive direction as the Democrats won the US Senate, US growth expectations were revised higher significantly. The FX market has in turn bought the USD on the expectation that US growth outperformance would also imply a rewinding of expansionary US monetary policy fairly soon. The jury is still out on whether we have already seen the lows in the USD, but unless the Fed moves fairly soon by announcing a tapering of QE purchases etc. we think we have another round of USD weakness ahead of us. We can also safely draw the conclusion that the USD outlook always plays a very important role for the SEK trade-weighted development and will likely continue to do so in the future. This means that strong USD cycles are combined with weak SEK and vice versa. At the start of 2021, the Riksbank also announced that it would start paying back the FX-denominated debt that the Debt Office had borrowed on behalf of the Riksbank in order to boost FX Reserves some 10 years

ago. Going forward, the Riksbank will sell SEK 5bn/month and buy FX until December 2023. This flow will neutralize about 25-30% of the current account surplus, hence it will not alter the trend, but it will create some headwind for SEK. It is also a signal to the market that the Riksbank is less happy about getting too strong a currency and you could also say that the timing signals that the Riksbank doesn't agree with us as regards the overall valuation of SEK which we still see as undervalued. International speculative funds may interpret this as a central bank that is less forgiving and that wants a weaker currency. But our overall stance is to anticipate a slow but steady appreciation over the coming three to six months and we think priceaction (in the graph above) support this view as well.

Positive SEK flows according to the balance of payments

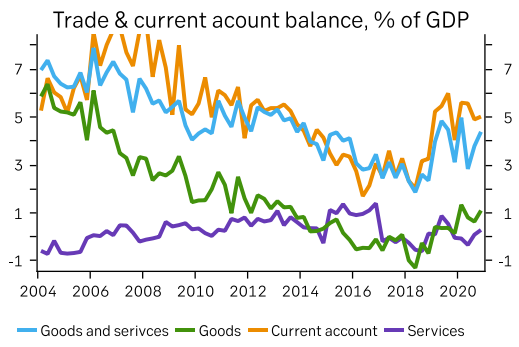
Sweden's current account balance turned higher in 2019 driven by a turnaround in the long downward trend in net goods trade. Both stronger exports and a slowdown in imports due to weaker domestic demand contributed to the turn. The upturn in trade was boosted further by the corona pandemic. The stronger inflow from the current account was matched by an outflow in the financial account driven by increased foreign deposit holdings by Swedish non-financial corporations. The central bank's QE purchases is the main driver for increasing domestic deposits from non-financial corporations and some of this seems to be spilling over into foreign deposits. QE is also driving deposits higher internationally, not least in the euro area, but this does not seem to have triggered a corresponding flow of foreign deposits in Sweden. **We highlighted in the SEK views from October 2020 that this implies that rate spreads could become more important as drivers for exchange rates.** Central banks are expected to continue to expand their balance sheets, most notably the ECB, which is likely to be supportive for the krona. Swedish non-financial corporations' holdings in foreign deposits could turn when the economy and fixed investments pick up. Also, the ECB's balance sheet is expected to further increase significantly going forward as we predict that PEPP purchases will continue throughout next year, while the Riksbank's purchase programme is predicted to end in December in line with current plans. This is likely to weigh on the euro vs other currencies.

Portfolio investments flows were largely neutral in 2020 with relatively large net outflows of equity. There was also a relatively large net outflow of long-term debt securities due to Swedish investors reducing their holdings, and even more due to foreign investors selling long-term debt securities. The developments in the equity flows show clearly that Sweden has a big net positive holding of equities in the net international investment position meaning in turn that equity flows will be SEK positive when global equity markets turn lower giving the SEK some defensive characteristics.

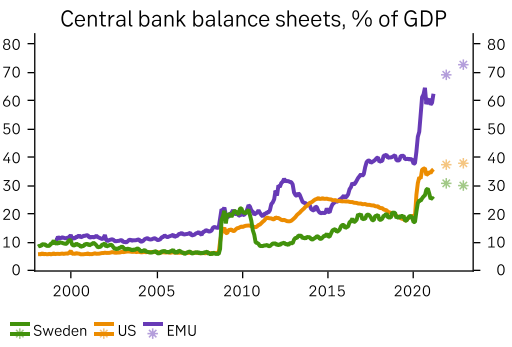
Swedish net Equity portfolio flows are SEK positive in times of falling risk appetite

	2015Q3	2015Q4	2016	2017	2018	2019	2020Q1	2020Q2	2020Q3	2020Q4	2020
Net Portfolio Flows	72,9	-117,1	50,3	27,6	-87,9	104,5	-103,3	23,4	54,0	55,0	29,1
Stocks and shares	-14,9	-67,5	104,6	122,2	-42,8	68,8	-93,2	74,9	107,5	92,6	181,8
Swedish Shares	-10,1	-7,4	-25,7	27,7	-0,5	10,9	8,8	15,3	7,5	34,8	66,4
Foreign Shares	**-25,0**	**-74,9**	78,8	149,8	**-43,4**	79,7	**-84,4**	**90,2**	**114,9**	**127,4**	**248,1**
Debt securities	87,8	-49,6	-54,4	-94,6	-45,0	35,7	-10,2	-51,6	-53,5	-37,6	-152,9
Swedish debt sec.	-109,8	55,6	3,8	196,9	38,1	-30,4	-46,4	14,3	75,0	18,2	61,1
Foreign debt sec.	-22,0	6,0	-50,7	102,4	-7,0	5,3	-56,6	-37,3	21,5	-19,4	-91,8

Current account surplus is trending higher / Riksbank balance sheet does not expand like ECB

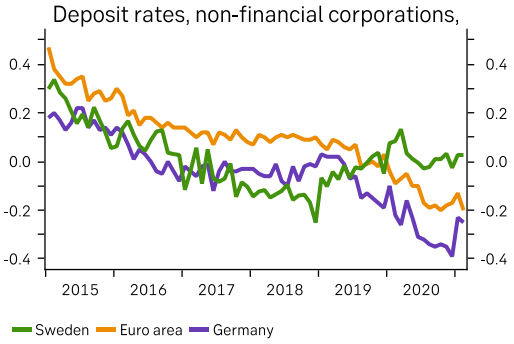


Source: Statistics Sweden (SCB), Macrobond, SEB

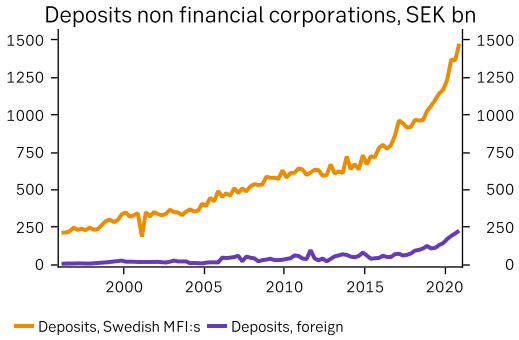


Source: Bloomberg, Macrobond, SEB

Deposits are rising fast and the rate spread to the euro area is turning SEK positive



Source: ECB (European Central Bank), Macrobond, SEB



Source: SCB, Macrobond, SEB

Net investment position now on a par with Germany

Over the years we have pointed to the continued surplus in the external balances of Sweden and the fact that the accumulated current account surplus never gave rise to a large accumulation in net assets. The latest data confirms that the net position is indeed developing in a very positive way and using market value rather than book value of foreign direct investment brings the net IIP to +74%/GDP. Using book value, which is the traditional way of reporting, net IIP is at +20%/GDP, which remains a strong figure. The positive net IIP should give rise to the SEK developing into a less risk sensitive currency. Equity flows are very positive in times of risk aversion as can be seen above. The large positive asset position of companies in net FDI does not yield bigger flows unless a change in tactics for investments abroad or equity hedging is adopted, which we don't foresee.

Sweden: Net International Investment position 2020 (FDI at market value) is now at 74%/GDP

	Assets			Liabilities		
SEK bn	1990	2003	2020	1990	2003	2020
FDI	282	1 785	7 507	71	1,158	4 142
Equities	59	1 025	5 341	38	645	3 376
Debt securities	10	492	1 324	66	1,379	4 034
Financial derivat.	---	215	555	---	220	501
Currency & dep.	---	7	1 843	---	---	1 858
Loans	---	640	912	---	1,083	370
Trade credits	---	71	128	---	50	131
Other	439	84	181	---	20	217
Reserves	104	161	481			
Total	894	4 480	18 271	1 541	4 555	14 630
Net		-	--	-647	-75	+3 641
Per cent of GDP				-26%	-2%	+74%

SEK valuation is still appealing to investors.

Our long-term fair value model signals that the SEK remains undervalued. The model is based on relative prices (PPP) (-), relative terms of trade (+), relative ULC (-) and real long-term interest rate differentials (+). When looking at the different factors in the fair value model, the real rate is the most important driver for currencies. Market developments are also indicative of real interest being the most crucial factor. In 2017-2019, the development in Swedish real rates drove the SEK weaker as Swedish inflation was at or even above the Riksbank's target whilst Swedish interest rates were well below zero. Last year, real interest rates moved in favour of the SEK at the expense of the USD and USD/SEK fair value estimate moved from 8.50 to 7.50. This is perhaps one of the strongest arguments for more USD weakness promoting the SEK to continue higher.

The SEK remains undervalued according to our models

SEK Long-term valuation

Ccy pair	LTFV	Spot	Dev. LTFV*	12m fwd	Dev. Fwd
EUR/SEK	9.78	10.13	4%	10.18	4%
USD/SEK	7.58	8.46	11%	8.42	11%
NOK/SEK	0.88	1.01	14%	1.00	13%
GBP/SEK	12.01	11.66	-3%	11.62	-3%
JPY/SEK	8.60	7.77	-10%	7.77	-10%
AUD/SEK	6.65	6.56	-1%	6.54	-2%
NZD/SEK	5.23	6.07	15%	6.03	14%
CAD/SEK	6.26	6.77	8%	6.75	7%
CHF/SEK	8.04	9.17	13%	9.23	14%

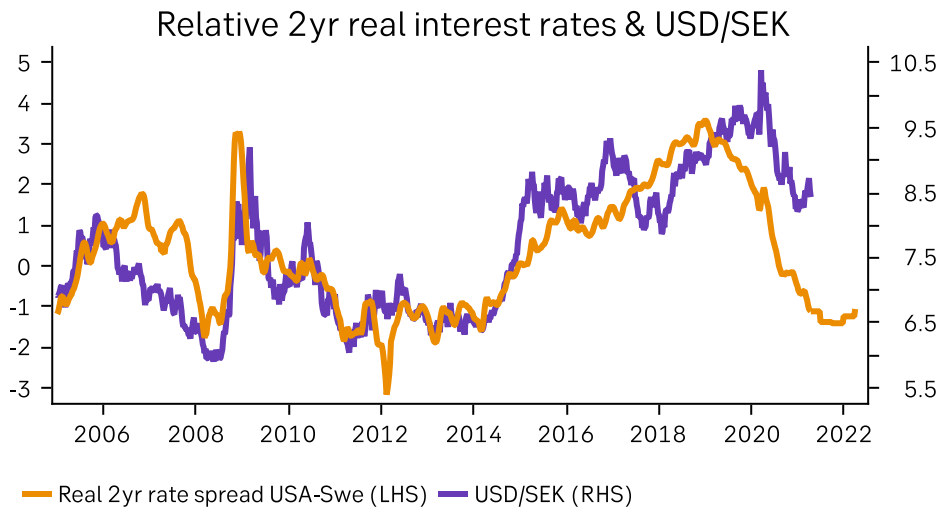
USD Long-term valuation

Ccy pair	LTFV	Spot	Dev. LTFV*	12m fwd	Dev. Fwd
EUR/USD	1.29	1.20	-7%	1.21	-7%
USD/CHF	0.94	0.92	2%	0.91	3%
USD/NOK	8.59	8.37	3%	8.38	3%
GBP/USD	1.58	1.38	-14%	1.38	-14%
USD/JPY	113	118	-4%	117.90	-4%
AUD/USD	0.88	0.78	-12%	0.78	-12%
NZD/USD	0.69	0.72	4%	0.72	4%
USD/CAD	1.21	1.25	-3%	1.25	-3%
USD/SEK	7.58	8.45	-11%	8.42	-11%

Positive value = USD is undervalued

Relative real interest rate developments remain SEK supportive

When we combine our forecast for relative inflation with our forecasts for policy rates and two-year interest rate differentials, the outlook remains clearly USD negative and SEK positive (see graph below). The outlook will depend on Fed policy and likely very little will have to do with Swedish developments (as the Riksbank will remain on hold for the foreseeable future). Unless the Fed moves towards tightening policy later this year, the negative valuation outlook for USD/SEK will drive the cross lower. In fact, the aim of Fed policy is to inflate the US economy and let CPI drift above the implicit Fed target. Only when the US economy is back at full capacity with inflation at or above target will policy tighten. This means that lower real interest rates backed by high inflation and a zero-interest rate policy is USD negative.



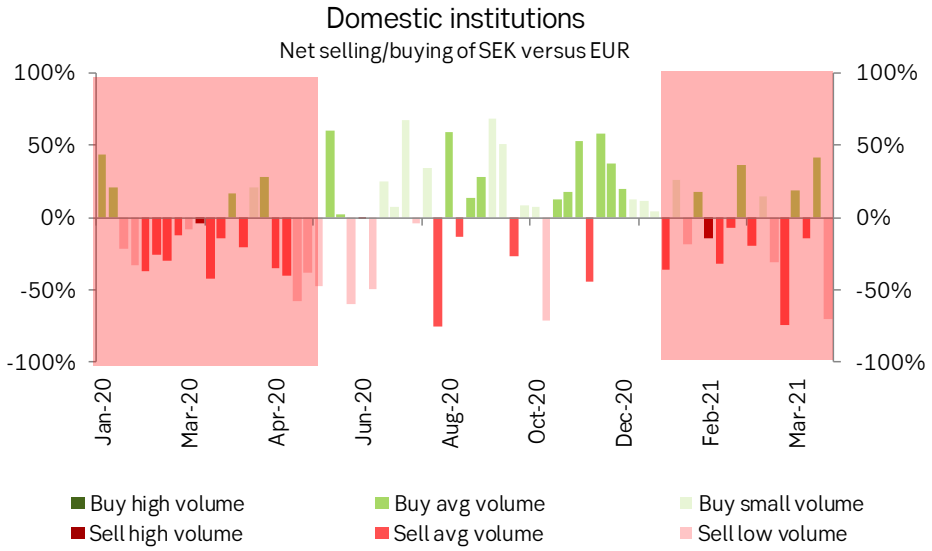
SEB internal SEK flows: stated versus revealed preference

As usual, we have studied our own flows for different client categories in order to check if market positioning is in line with the stated preference in the FX survey. In short, we think there is clear support for the small increase of the Corporate SEK underweight but less so for, at least a large, downscaling of the Financial heavy SEK overweight.

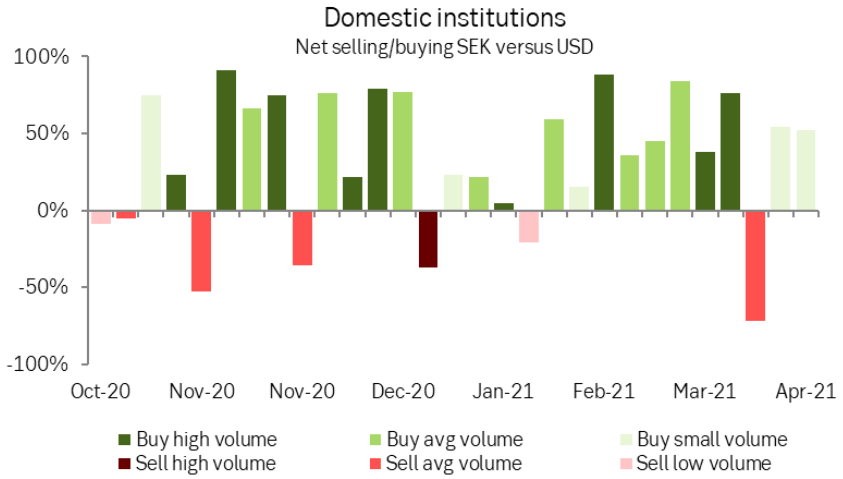
Own positioning

Domestic institutions have clearly gone through three phases since the beginning of 2020. They were more frequently net sellers of SEK in H1, net SEK buyers in H2, and once again more frequently

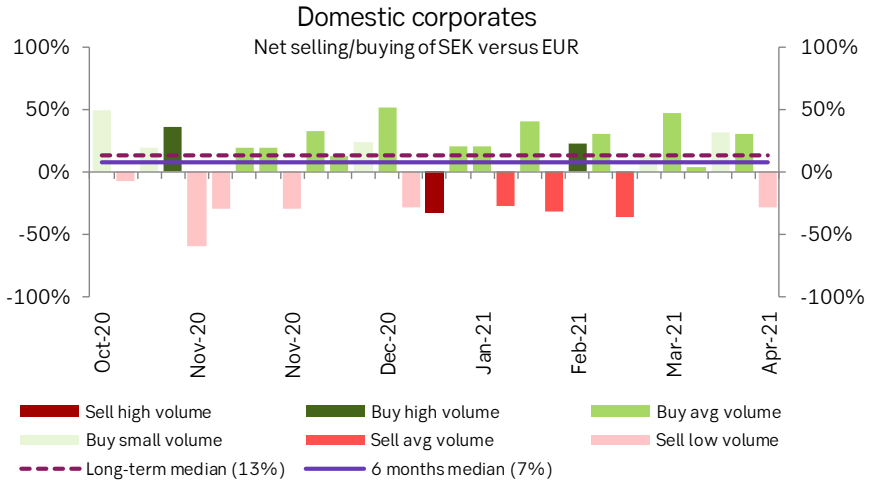
selling SEK in 2021. This reflects rather well the downscaling of the SEK overweight from October 2020 to April 2021.



However, the exposure for our domestic institutions is mainly towards the USD. But looking instead at the USD/SEK flow, it does not clearly support a sharp decrease of the net SEK overweight as the majority of weeks come with heavy SEK buying. But, the value of the underlying assets also increased largely over this period which requires SEK buying just to keep the stipulated hedging ratio. That should explain at least some of the net SEK buying seen in our flows but still we do not see a great support from the revealed preference in our flows for the stated preference in the survey of a sharp downscaling of the record net SEK overweight position seen in October 2020.

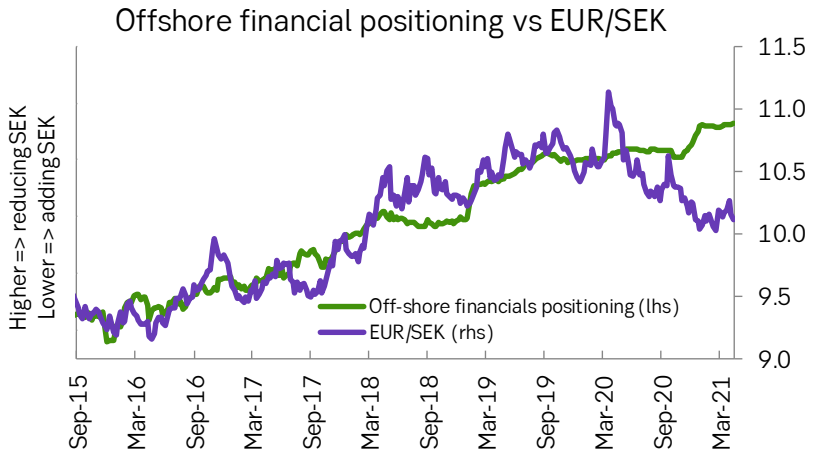


Domestic corporates are notorious net SEK buyers but looking at the period since the previous SEK Views report (Oct 2020) the average net buying sentiment index has been lower than the long-term average (7% vs 13%) which confirms the move in the survey from a net own position of -4% to -9% for corporations.



Market positioning

The survey participants believe that the market as a whole has added slightly to the tiny overweight shown in the previous survey as the net result is +7% vs +2% in October 2020. Using our client flow from international financials as a proxy for the market in general does indicate that the long EUR/SEK positioning during the autumn was followed by a relatively neutral development in 2021. EUR/SEK and our offshore financial positioning index seems to have disconnected past September 2020. Currently the spread is the largest since the start of the index back in 2015 and we do not expect a EUR/SEK to close the spread as otherwise have been common in the past.



Macro & FICC Research

SEK Empirical analysis

Wednesday, April 21, 2021

SEK Drivers: Correlations and scenario analysis

In the following text we seek to explain what empirically explains movements in the krona. We begin with a classical correlation analysis but as this mainly shows what works during normal times we have complemented it with a more detailed study of recent drivers (US long-rate focus vs Swedish equity dividend seasonality) as well as a scenario analysis comparing and explaining the differences in impact between the global financial crisis and the outbreak of the Covid pandemic. Based on these findings we also look into SEK sensitivity to potential and future sharp equity market corrections.

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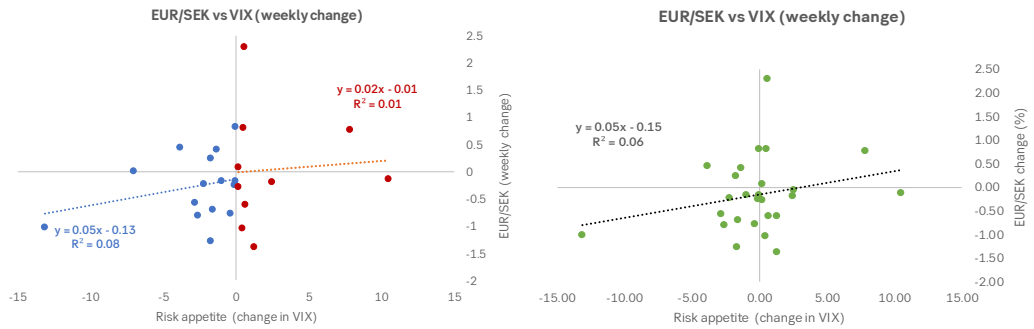
EUR/SEK is symmetrically correlated with risk again

During the autumn the correlation on a weekly basis was far smaller than usual (0.2 with a regression only explaining about 6% of the weekly moves). However, a conditional correlation analysis, splitting the reaction in EUR/SEK between how it correlated during risk-on weeks versus risk-off weeks, revealed that EUR/SEK still tended to fall during risk-on weeks (i.e. high correlation) but that it was during risk-off weeks that the correlation had broken down, as EUR/SEK headed higher roughly 50% of the time and lower 50%. Thus, the reason for a breakdown in correlation seems to be some SEK buying flow that was not as impacted by risk appetite as is usual in SEK trading. We conclude that this could be because of SEK buying from domestic institutions which came on the back of the Fed cutting rates and hedging of US assets becoming significantly cheaper.

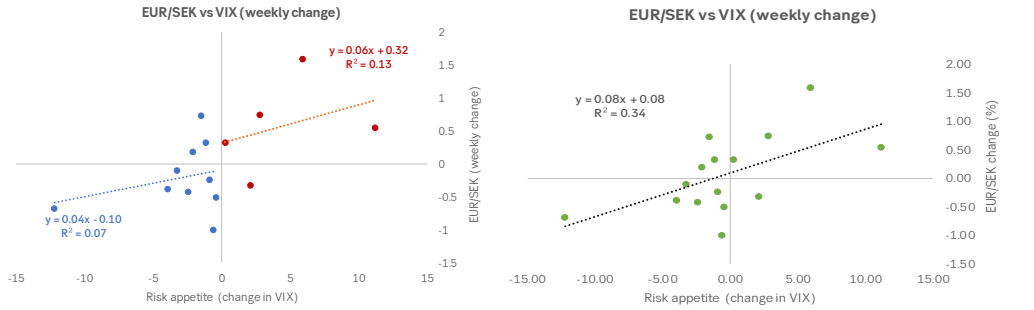
EUR/SEK only correlated well when risk appetite increased H2 2020



Source: Bloomberg, SEB

Conducting the same analysis on EUR/SEK so far this year reveals that the unconditional correlation has increased and that it doesn't matter so much if there is a risk-on or risk-off week: i.e. there is symmetry between the unconditional correlation. Overall weekly changes in risk appetite now explains as much as 34% of the weekly moves in EUR/SEK vs 6% H2 2020.

EUR/SEK correlation is much higher in 2021 and works both when risk appetite rise and fall

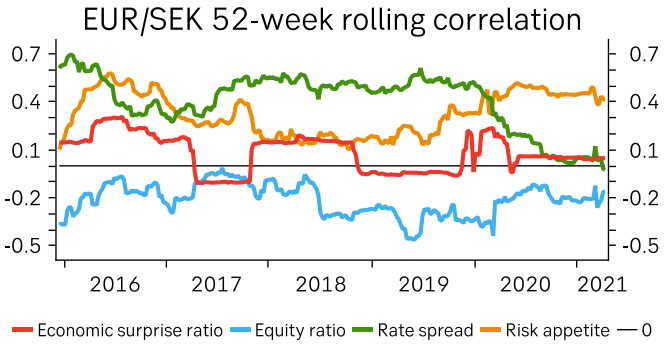


Source: Bloomberg, SEB

SEK correlates with risk appetite rather than the rate spread

An unconditional rolling correlation using a yearly lookback period on weekly data clearly shows that there have been some large changes in the correlation patterns in recent years. Historically, EUR/SEK has shown the largest and most consistent correlation versus the rate spread (here using 2y swap rates) but this correlation has dropped significantly since the beginning of 2020 and is even now flirting with a small negative correlation. The correlation between EUR/SEK and risk appetite instead increased in 2019 and remained high in 2020 with a small dip in the autumn, as mentioned above, but is clearly the time-series that EUR/SEK correlates most with currently. The relative development of economic surprise ratios has from time to time shown a burst in correlation but is low overall. Also, the correlation with the equity ratio is unstable and has fallen since the start of the pandemic. Interestingly it is negative the whole time, supporting the idea that equity flows between countries are governed not by capital seeking higher returns but rebalancing so that stipulated portfolio weights remain within certain boundaries.

EUR/SEK is correlating well with risk appetite, but the rate spread correlation broke down 2020

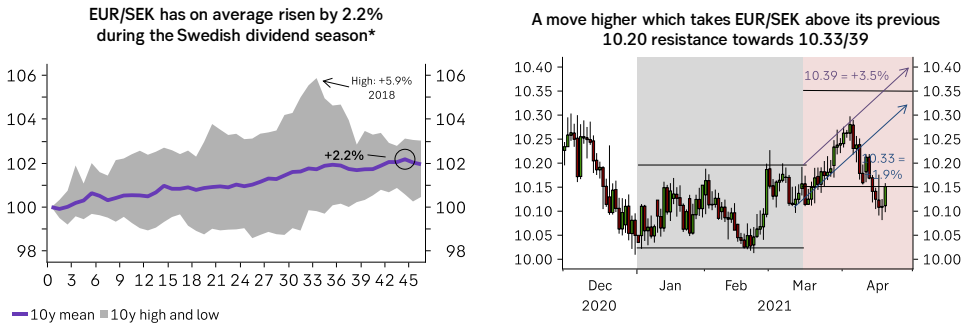


Source: Citi, Bloomberg, Macrobond, SEB

Rising US long yields dominating the Swedish equity dividend seasonality

Historically there has been a very clear seasonal SEK pattern between the latter part of March and the latter part of May where EUR/SEK increased during this period every year between 2010 and 2019. We believe that the main reason for this has been that there is an outflow of SEK during this period due to Swedish corporations paying out dividends. However, the weakness may also partly be attributed to the long-lasting uptrend in EUR/SEK (seven out of those 10 years) as well as the Riksbank tending to surprise on the dovish side in its April rate decisions. Furthermore, even after removing the impact from the trend and Riksbank components to the seasonal pattern the average impact feels too large compared with the likely size of the actual SEK outflow. Therefore, we believe the seasonal pattern to be driven not solely by flow but also driven a lot by expectations and actions in the market. The smoothness of the impact during the period as opposed to the lumpiness of the dividend payouts supports this notion.

EUR/SEK has tended to rise during the Swedish equity dividend season

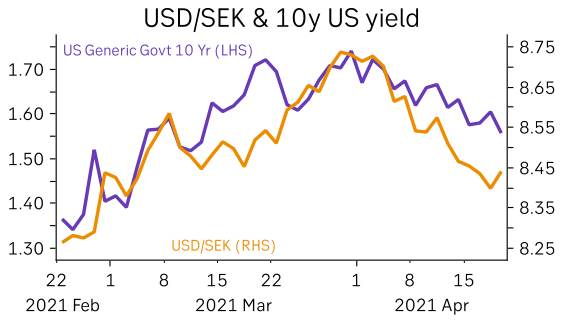


Source: Bloomberg, SEB

Last year, EUR/SEK managed to fall during this dividend period but that was because the dividends were halted due to the pandemic. This year we expected the usual pattern to reappear but that the impact would be smaller because there was no uptrend in EUR/SEK and because we didn't think the Riksbank would have as large an impact as previously. At the beginning of the period EUR/SEK moved according to our expectation, breaking above the 10.20 level for the first time in 2021 and almost reaching 10.30. After Easter, however, instead of continuing towards the 10.35 area – which the seasonal pattern indicated – EUR/SEK headed sharply lower and it now trades around 10.15. Looking at drivers lately it is now clear to us that the seasonal pattern was not strong enough

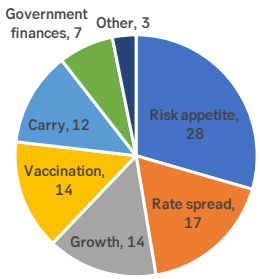
compared with the international mega theme of rising long-term US yields. As can be seen in the charts below, it was rather this theme that dictated the FX market and when there was a correction of the theme the SEK took its cue from there.

USD/SEK has followed the development of the 10y US government yield well lately

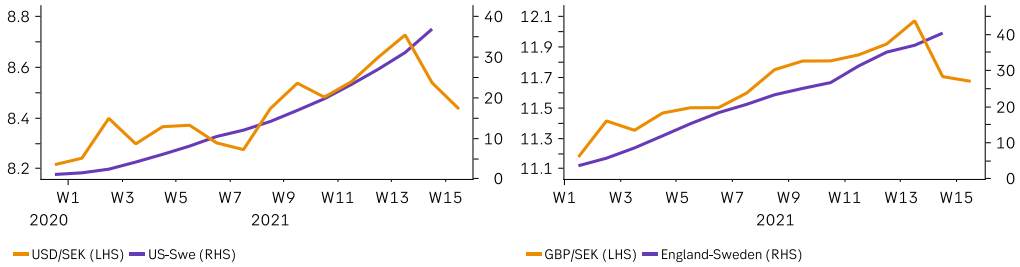


For how long will the long-term US yield be the main driver of the FX market? The US 10y yield has corrected part of its sharp rise in February and March and we expect it to be more range-bound in Q2 (read more in our SEB FI & FX Strategy here) and it should thus have a waning impact on FX. However, we expect Fed tapering formally to be announced in September and to begin in October so it might return to the forefront of FX drivers during the latter part of summer. What is likely to take over as the major FX driver when the impact from the long US yield wanes? That is the million-dollar question and – according to the survey answers regarding main drivers in the coming six months (albeit specifically for SEK) – the attention of the FX market should now switch to risk appetite and changes in rate spreads. As we discuss in the flow article, we share the view that rate spreads will gain in importance for the SEK and, as shown above in this article, EUR/SEK is so far in 2021 trading with a higher correlation vis-à-vis risk appetite while this also seems like a likely driver when the focus on the US long yields wanes. However, we have also found that the relative pace of vaccination has worked well to explain recent SEK weakness at least versus the countries where the vaccination speed stands, out which is evident in the charts below.

Survey response regarding SEK drivers the coming 6 months



SEK weakness went well with relative vaccination rate until the correction of the US yield



Source: Our World in Data, Macrobond, SEB

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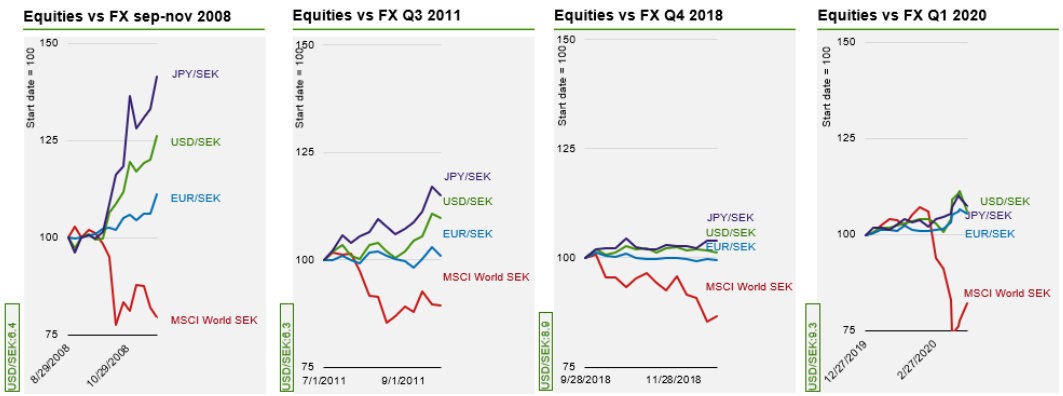
Impact on SEK during sharp equity market corrections has decreased

SEK has not been a weak currency during the pandemic. Historically, the SEK has been among the weak currencies when there is market turmoil. That was clearly the case during the global financial crisis (GFS) 2008-2009 during which SEK lost around 27% (TCW index) in the space of six months. However, the SEK weakness has been much milder during the pandemic than in previous crises, which is evident in the charts below showing the GFS, euro crisis, equity drawdown in late 2018 and the pandemic. Especially the impact during the pandemic in 2020 was much smaller as the SEK only lost around 5% over about three months (i.e. about 82% less than during the GFS). Other assets were similarly hit with e.g. the S&P falling 49% during the GFS and 35% during the pandemic (i.e. only about 29% less). A better comparison is the NOK, which also tends to weaken during market turmoil as do most currencies backed by small countries that are trade-dependent. The NOK (I44 index) lost about 22% during the three first months of the pandemic as well as during the six months of the GFS. Thus, it clear that the reaction pattern to large crises, measured as severe equity drawdowns, has materially changed for the SEK.

Event	US S&P 500	NOK (I44)	SEK (TCW)
Global financial crisis (6m)	-49%	-22%	-27%
Covid pandemic (3m)	-35%	-22%	-5%
Difference (GFC to CP)	29% smaller	Equally large	82% smaller

SEK during sharp equity drawdowns 2008-2020



- During the GFC the depreciation of SEK was huge vs JPY, USD and also EUR
- In 2011 the Eurozone debt crisis saw stock markets tumble 17%[1]
- SEK weakened substantially versus the JPY and USD
- At the end of 2018 stock markets fell sharply
- SEK weakened only very slightly vs JPY and USD and not at all vs the EUR
- Stock markets tumbled as covid-19 spread to Europe
- Initially SEK strengthened but weakened when the financial market came under stress

What is different and will it be the same if we enter a new phase with a sharp equity drawdown? We have identified five main reasons for the smaller SEK weakness during the pandemic compared with the GFC period. These are discussed in the table below where we believe the ones in italic are still valid should world market enter a new phase of severe equity drawdowns.

Setting ahead of the financial crisis: SEK negative	Setting ahead of the pandemic crisis: SEK positive
Swedish rates higher than US rates – SEK negative when the Riksbank adjusted rates lower	**Swedish rates lower than US rates** (and with assumed 0 a floor) – SEK positive when the Fed adjusted rates lower
Carry trades very popular and SEK a long position	**Carry trades** not as popular but SEK a main short position (i.e. getting JPY, CHF like characteristic)
Hedging was done with high hedging ratios and long durations (and hedging was cheap due to the positive rate spread)	***Hedging*** *was only done with low hedging ratios and short durations (and hedging was expensive due to negative rate spread)*
Swedish net international investment position balanced i.e. foreigners owned about as much in Sweden as Swedes owned abroad	***Swedish NIIP positive*** *i.e. Swedes owns more abroad than foreigners own in Sweden – i.e. a defensive balance sheet*
SEK overvalued versus the USD	***SEK undervalued*** *versus the USD*

Based on this we believe that the SEK will experience a larger loss if world equity markets collapse now compared with what happened in 2020 but the loss should not be as large as during the GFC.