

The Interesting Case of the Swedish Krona

Sweden's central bank, the Riksbank, meets on Thursday. It is the same day as the ECB meeting and is likely to be overshadowed by it. Yet there is something important happening in Sweden that is worth looking closer at.

Riksbank Adopted Negative Deposit Rate in Early July

Central banks in Europe place their key rate between a deposit rate, what the central bank pays on reserves or some fraction of them, and the lending rate, what the central bank receives on certain types of loans to banks.

For example the ECB, sets the overnight deposit rate at 0.25% and the overnight lending rate at 1.75%, while the one week repo is 1%. The Riksbank sets its deposit rate at 50 basis points below its repo rate. On July 2nd, the Riksbank surprised the market by cutting its repo rate to 25 basis points from 50 basis points. And that means that the deposit rate is set at -25 basis points. Yes, a negative deposit rate.

Swedish krona and British Pound

What has the Swedish krona done since July 2nd? It has simply been the best performing G10 currency, having risen almost 9% against the U.S. dollar and just shy of 7% against the euro and more than 10% against sterling. Most of the gains were scored in July, though this month the krona has consolidated those gains, and has edged 0.6% higher against the dollar, 0.4% against the euro and 3.7% against sterling.

Ironically, then one source of pressure on the sterling is coming from ideas that the BOE may follow the Riksbank. The BOE meets not this week but next Thursday, September 10th. Why does the market suspect the BOE? First the BOE surprised the market by extending its quantitative easing by GBP50 billion, which is twice what even the most aggressive economists had expected. Second, the BOE's King did not rule it out when specifically asked after the recent inflation report.

Freeing Up Reserves?

Although the debate in the U.S. is whether the Federal Reserve can prevent the excess reserves it has created from chasing goods and service; generating an increase in the overall price level, i.e., inflation, the debate in other countries, like Sweden and the UK, is can the private sector banks be induced to lend by reducing the rate they can earn on deposits with the central bank.

King specifically indicated that the BOE would be discussing whether a cut in the interest rate on reserves would help augment the effectiveness of its asset purchases. Here's why: The BOE has purchased around GBP140 billion gilts and corporate bonds and between early March and the end of July, commercial bank deposits at the BOE have risen about GBP120 billion.

Foreign Investors in Sweden

International investors are more exposed to Sweden than one might suspect given its \$480 billion GDP (2008—roughly the size of Switzerland or the state of New Jersey's GDP, for perspective). Foreign investors are the single largest investors in the Swedish stock market, accounting for a third of the market capitalization at the end of last year. Foreign investors also own about 22% of Sweden's outstanding bonds.

Sweden's main equity index, the OMX Stockholm Benchmark Index is among the best performers in the G10 thus far this year, rising a little more than 41%. Its 10-year bond yield has risen 88 basis points this year, though at 3.28% currently, it is only 5 basis points on top of Germany and still 12 basis points below U.S. Treasuries.

The Swedish krona was one of the worst performing currencies in the second half of last year and has spent the better part of the year correcting the overshoot. The same forces appear at work with Sweden's other asset classes.

It looks like the dollar has found some tentative support against the krona near SEK7.0. Resistance is seen near SEK7.40. However, more immediately watch the SEK.7.17 area, where a convincing penetration could be an early signal the move has begun.

Marc Chandler

Global Head of Currency Strategy