SEK: mind the gaps

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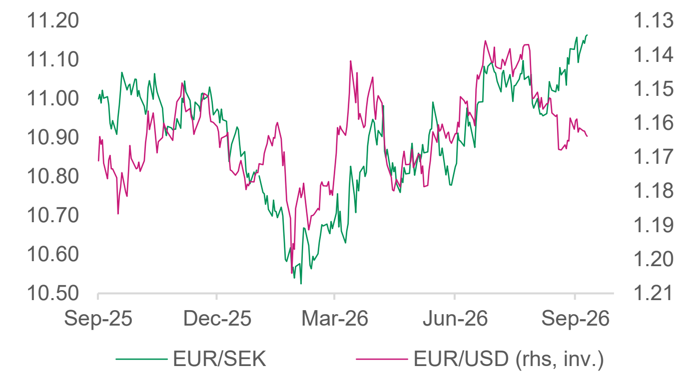
- **The SEK has gone from being by far the top G10 FX performer in 2025, to the bottom of the pile this year. Looking at a more granular level, it has been a gradual process throughout the year, rather than a sharp turnaround, while such a SEK pullback has not come without backing. In our view, the SEK rally into 2026 had gone too far too soon. Sweden faces a negative terms-of-trade shock from higher energy prices, the Riksbank has lagged the more hawkish shift of other central banks, while the SEK has also likely suffered from its nature as a high-beta EUR proxy.**
- **This last relationship has notably endured some asymmetry over the summer, with the SEK being unable to benefit from the EUR/USD rebound, to stay among the G10 FX laggards this quarter. A possible reason is that the SEK rate disadvantage to the EUR has resumed worsening over that period. Contained inflation in Sweden, even when stripping out this year's fiscal measures, has bought the Riksbank more time, although FX and the prospects of excessive SEK weakness usually carry a heavy weight in its reaction function.**
- **The peak in ECB-Riksbank divergence may thus not be too far away, especially if today's ECB stance is to underwhelm EUR money markets. Once reached, the SEK could then focus back on the more appealing domestic fundamentals relative to its EU peers. The Swedish economy is set to grow twice as fast as the Eurozone this year and next, while still enjoying much sounder public finances.**
- **The outcome of this weekend's general elections in Sweden should not alter that. Another coalition government looks on the cards, as opinion polls suggest that the race between the two main blocs has become too close to call. Key there is that the major parties on either side back fiscal discipline, continuing to fiscally support activity with no major tax overhaul. While the market expects no major shake-up anyway, just removing uncertainties could be enough to somewhat clear the SEK path.**
- **We thus continue to expect EUR/SEK to resume drifting lower later this year, albeit admittedly later than we had thought and from a more elevated base of one-year highs just shy of 11.20 at present.**

The SEK went into 2026 on the front foot, having outperformed all its G10 FX peers by at least 5% in 2025, even registering annual gains of 20% against the USD and almost 7% against the EUR. At the time, we warned that the rally had likely gone too far too soon, and therefore some consolidation could be on the cards. The SEK has since done a bit more than just taking a break, instead hitting one-year lows against the USD and the EUR as it has lagged all G10 FX so far this year. Increased geopolitical turmoil in the Middle East and its macro/financial ramifications could explain most of that. Just like most of Europe, the Swedish economy faces a negative terms-of-trade shock from higher energy prices, while it has also suffered from its nature as a high-beta EUR proxy with EUR/USD drifting lower. Furthermore, unlike the EUR, the SEK could not find any support from a not-so-hawkish Riksbank relative to most other central banks.

Record policy gap in sight

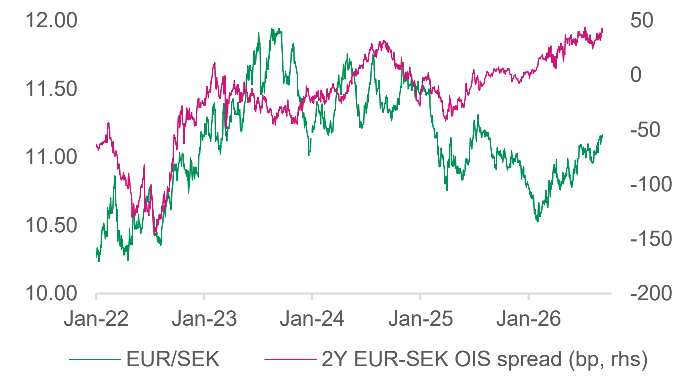
A notable development of the past month or so is that the SEK's high-beta proxy relationship to the EUR has faced some asymmetry, with the SEK being unable to benefit from the rebound in EUR/USD towards the middle of its range. A possible explanation is that the SEK rate disadvantage to the EUR has resumed worsening over the summer, with the Riksbank being set for a record lag in its policy rate relative to the ECB which is set to raise rates for a second time today. In a context of fairly contained realised volatility across FX markets, carry differential may matter even more and EUR bears may have thus switched to the SEK as an alternative at lower funding costs.

Fig 1. The SEK unable to benefit from being a high-beta EUR proxy amid EUR/USD rebound



Source: Crédit Agricole CIB, Bloomberg

Fig 2. Widening EUR-SEK rate differentials may have impeded the SEK



Source: Crédit Agricole CIB, Bloomberg

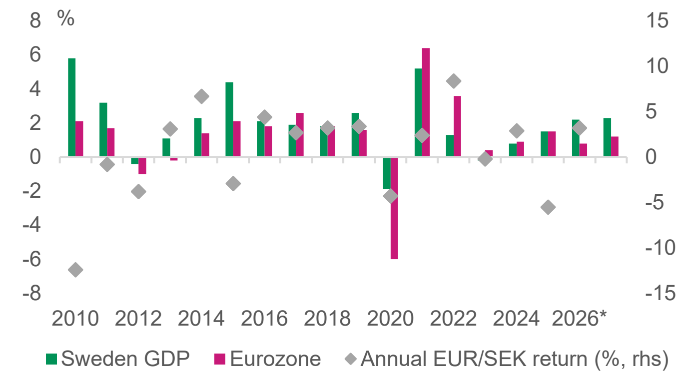
The Riksbank has indeed lagged behind the more hawkish turn followed by other central banks, albeit for good reasons. Swedish inflation has remained better behaved than most other developed economies, even when taking into account the fiscal measures that have come into effect through the year to soften the cost-of-living impact, and that have roughly depressed CPIF rates by about 1.5ppt. Stripping out such one-offs, both headline and core inflation would have remained close to the 2% handle, while August's flash figures have reduced the overshoot relative to the Riksbank's June forecast to almost nothing. In that context, the Riksbank could prolong its wait-and-see stance at the September meeting, although another prominent factor may get more attention. Despite being absent from the August minutes, undue SEK weakness could spur a prompt response from the Riksbank in order to swiftly mitigate the threats of stronger imported inflation, with the 2022-23 experience still very much in mind. As a result, with the Riksbank policy rate being poised to be 75bp below the ECB deposit rate for the first time ever after a likely hike today, and the 2Y EUR-SEK rate spreads still threatening to eye new highs near 50bp, peak policy divergence may not be too far down the road in our view.

More favourable comparison elsewhere

Once that is the case, the SEK could then focus on other factors where Sweden fares relatively much better than the rest of its EU peers: growth and public finances. Following years of at best at-par growth, Sweden is set to outperform significantly the Eurozone this year and next, with activity potentially expanding twice as fast over that period. The greater fiscal impulse delivered this year has undoubtedly helped to comparatively boost personal consumption, while at the same time a faster transmission of a more accommodative monetary policy has likely played its part. In the past, such periods of significant growth outperformance between Sweden and the Eurozone have usually brought some gradual SEK gains against the EUR and we would not expect anything much different this time around. This gear differential has only started to be visible in the Q226 data, and as a result extra months' worth of data may still be needed to confirm that the trend has become well entrenched, as the negative prints seen in the June-July GDP have been described more as a normalisation of the exceptionally strong May number.

An area where Sweden's superior appeal should be hard to argue against is public finances. Despite making greater use of its fiscal headroom, the Swedish government should run a budget deficit well below the 3% of GDP mark before a return towards balanced books soon after. In any case that would leave the public debt metrics in a sound position below 40% of GDP, whereas many EU countries face a much bigger tally that is getting increasingly expensive to service. Therefore, in a context of growing fiscal concerns/surging long-term yields, the SEK should offer a good shelter relative to the EUR.

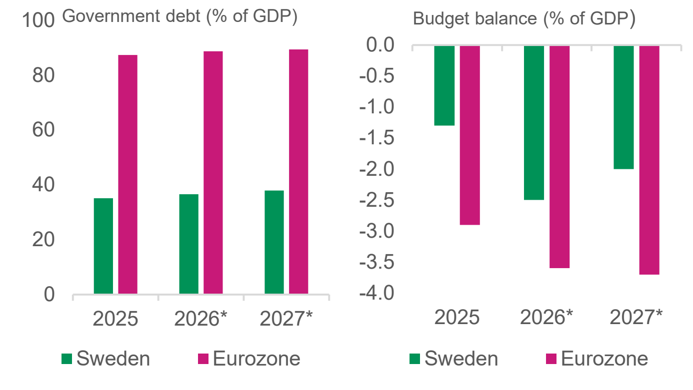
Fig 3. Relative growth outperformance usually brings SEK gains vs the EUR too



Source: Crédit Agricole CIB, Bloomberg, ECB, Riksbank

** Forecasts*

Fig 4. In a context of rising long-dated yields, Sweden's healthy public finance should shelter the SEK

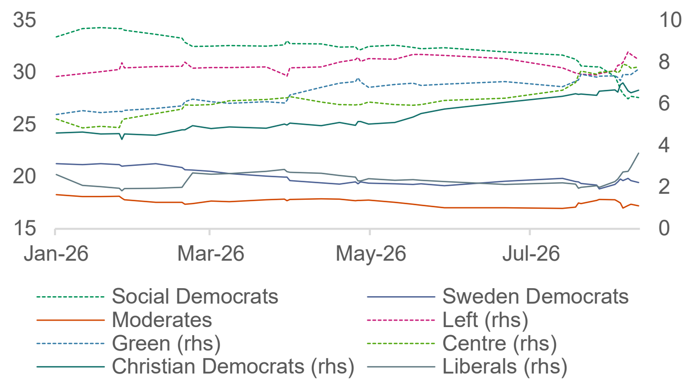


Source: Crédit Agricole CIB, ECB, Riksbank

Election too close to call

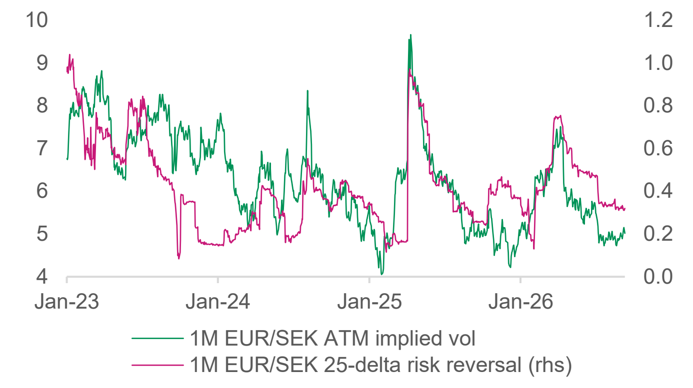
We do not expect Sweden's compelling fiscal stance to be threatened by the next general election this weekend. Until a month ago, the bloc led by the Social Democrats enjoyed a comfortable lead in the opinion polls, which has now fallen within the margins of errors. Yet, a deciding factor in terms of final seat allocation lies with whether the Liberals (which are presently part of the Tido alliance) could reach the 4% threshold at the national level. In any case, Sweden has been used to running with coalition governments for the past twenty years, and in some cases in a minority framework. Therefore, with the three largest polling parties not pledging to depart from some sort of fiscal discipline, risks of budget slippage appear fairly limited, even though some parties in the opposition have called for a greater tax overhaul. Furthermore, lengthy negotiations to secure a coalition agreement already occurred in the past without shaking up domestic markets and/or the SEK in the process. In that context, FX option markets have again not embedded any major risk around that event, and therefore, Sunday's outcome should not be too consequential for the SEK which may still enjoy some uncertainties being cleared off the table, if at all.

Fig 5. The gap has closed for the opposition bloc in the latest opinion polls ahead of Sunday's election



Source: Crédit Agricole CIB, Wikipedia

Fig 6. As usual, FX options do not price in any major risk around that event



Source: Crédit Agricole CIB, Bloomberg

Conclusion

Despite reaching fresh one-year highs just shy of 11.20, we still expect EUR/SEK to resume drifting lower later this year. Peak policy divergence between the Riksbank and the ECB may need to be reached for that, as the focus may then shift back to Sweden's more appealing feature relative to the Eurozone on the growth and fiscal fronts.

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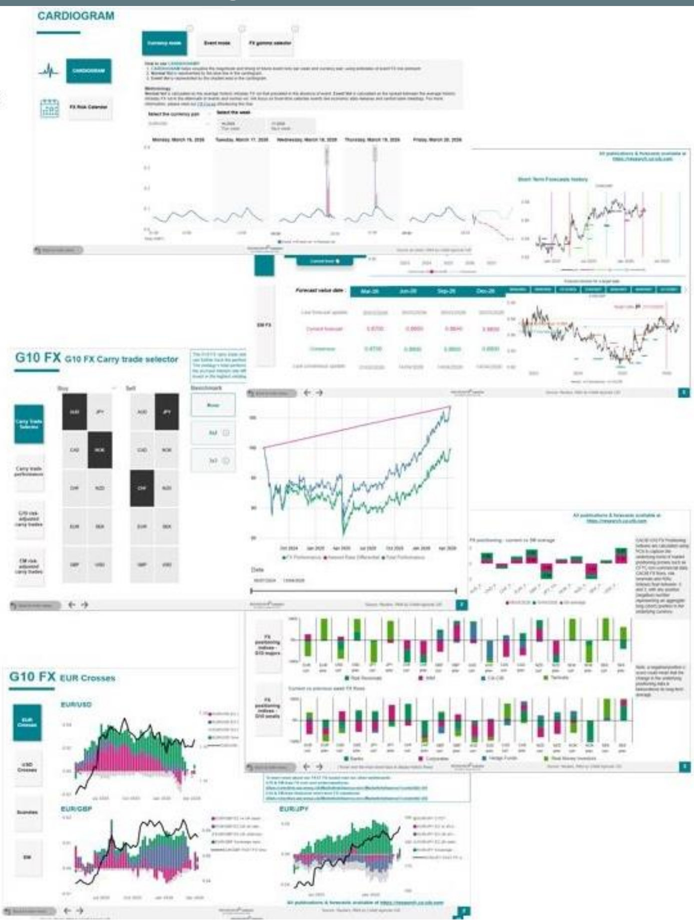

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