



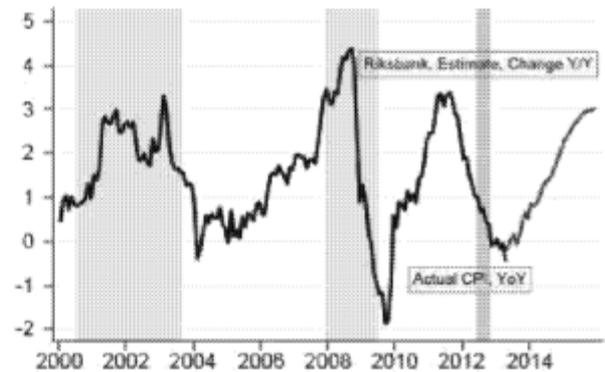
Meanwhile in Sweden imported deflation is dragging headline CPI further below the Riksbank's projection (in April -0.5% YoY vs the -0.2% projection). For the inflation targeting Riksbank this should mean further policy easing, and it might result in further cuts. However, as the majority on the board has made clear, they are not entirely comfortable reducing rates further in response to external disinflation when house prices are edging higher and households take on more debt. Also, further rate reductions would not necessarily support demand since the slowdown was/is due to weak sentiment and a poor external environment.

Meanwhile in the real economy, data is generally a mixed bag, with a few very early indications of a turnaround. Retail sales are largely stable, and consumer sentiment is back in the positives, backed up by higher property prices and surging equities. In the manufacturing sector the PMI remains just below the 50 benchmark line, but hard industrial data has improved significantly of late, with industrial output up 0.8% on the month in March for a flat YoY reading, while the more forward looking new orders component rose a sharp 10.5% MoM and 11.2% YoY, the highest YoY outturn for 2 years.

So where does this leave the krona? On the back of the CPI report the rates market is almost fully priced for a further 25bp rate cut over the next two meetings. This to us seems about right, as even given the reluctance of the Riksbank neutrals to solely focus on the CPI, they can also not ignore headline CPI when it is running so much below target. However, at current levels (8.65) we also see limited downside in the SEK vs the EUR. In the current environment and at current policy rate levels, policy expectations can only impact on the SEK to a degree, with positive flows dynamics (C/A surplus a solid/steady 7-7.5% of GDP), attractive valuations (see DB's BEER, FEER and PPPs), and more near-term a lack of positioning (SEK a net short on dbSelect, investors have not been this short the krone for almost a year). Therefore we believe the probability of further rate reductions in the SEK is best captured in short SEK vs the NOK, where the CPI gap will continue to underpin expectations for a wider policy rate gap. Look for a return to the highs from late last year. Our initial target is 1.1775, with a stop just below 1.12.

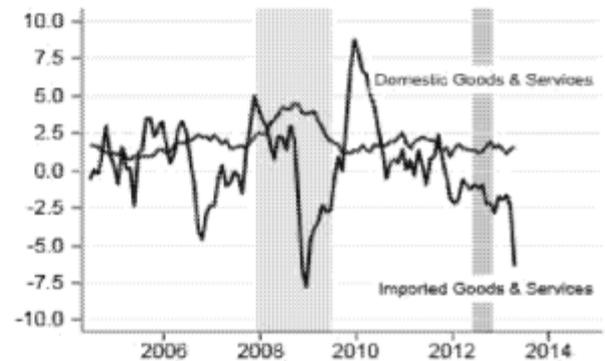
Henrik Gullberg, London, [REDACTED]

Figure 4: Inflation is running below Riksbank forecasts



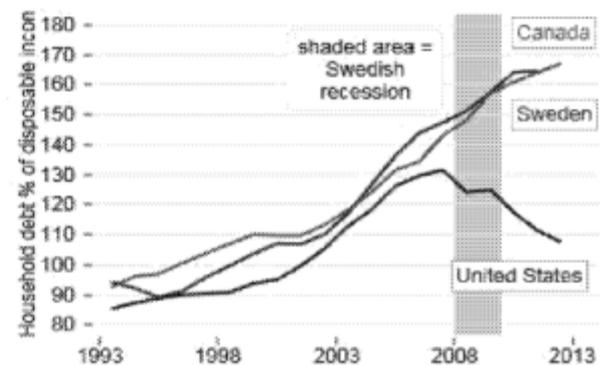
Source: Deutsche Bank

Figure 5: Domestic inflation stable - imports hugely deflationary



Source: Deutsche Bank

Figure 6: Household debt as % of disposable income



Source: Deutsche Bank