

Summary

Why has the Swedish krona depreciated so much in the foreign exchange market? The question may seem simple, but there is no easy answer.

First, the krona has not depreciated much at all if we compare the exchange rate to an index of currencies, where the index weights correspond to the importance of the different countries for Sweden's foreign trade. In relation to such an index, the value of the krona is currently only slightly below what it was when Sweden abandoned the fixed exchange rate for a floating rate just over 30 years ago. The krona has fluctuated during that time – sometimes it has been substantially stronger and sometimes weaker. In 2012–14, for example, it was unusually strong, and since then it has depreciated to the rate it had in the 1990s – and it is possible that this fall to a more average level has been perceived by many as the dramatic fall of a “junk currency”.

Second, although the krona has been stable against an index, it has depreciated against some currencies and appreciated against others. The currencies against which it has depreciated include the euro and the US dollar. These exchange rate changes are probably particularly painful for Swedish tourists, while there are fewer Swedes that benefit from the krona's sharp appreciation against, for example, the Turkish lira and the Brazilian real.

But isn't it bad that the krona has fluctuated so much – even if it seems to do so around a rather stable average? One answer could be that such fluctuations are favourable: the Swedish krona has tended to depreciate when there has been a crisis in the world economy, protecting the Swedish economy from some of the effects of the crisis. This was the case when the IT bubble burst in 2000, the US banking system went into crisis in 2008 and Russia invaded Ukraine in 2022. This means that a junk currency can sometimes be a good

thing, but not always. During the eurozone debt crisis in 2010 and the COVID-19 pandemic in 2020, the krona appreciated because Sweden was less affected by these crises than many European countries, which meant a cost for Sweden's export industry – we simply had to help pay for other countries' policy mistakes. If Sweden had joined the EU currency union from the start, Sweden's exchange rate against an index of currencies most important for its foreign trade would have been much more stable, with both pros and cons.

Quite apart from the volatility of the currency during crises, financial assets, such as stocks, currencies and long-term bonds, often tend to fluctuate a lot. In fact, this seemingly random fluctuation is a sign that financial markets are working efficiently. This may seem paradoxical – one would think that in an efficient and well-functioning market, prices would move steadily and predictably but that is not the case. On the other hand, the seemingly random fluctuations can sometimes appear excessive, and although the Swedish krona has not fluctuated nearly as much as some other currencies in recent years, the fluctuations in the krona are apparently large enough to cause surprise and disappointment.

We have not found that the most common theories of exchange rate determination (the so-called purchasing power parity and interest rate parity theories) provide an explanation for the development of the krona exchange rate. And while the theory of purchasing power parity can explain the sharp falls of the Turkish lira and the Brazilian real, it is not sufficient to explain the relatively weak position of the Swedish krona. Sweden has in fact had lower inflation than most countries and, according to purchasing power parity theory, the krona should have appreciated.

The conclusion is that the slight depreciation of the krona against a trade-weighted index of foreign currencies over the past thirty years is difficult to explain – in fact, it has been so insignificant that it hardly needs explanation. However, the depreciation of the krona against the US dollar over the past ten years requires an explanation. This is not unique to the krona, but a universal phenomenon. All significant currencies, including the euro and the Swiss Franc, have depreciated against the dollar during the last decade. The dollar seems to have served as a safe haven in a decade of increasing global uncertainty.

We have examined some factors that are particular to Sweden and that may have weakened the krona further against the dollar. We have not found that the Riksbank's (i.e. the Swedish Central Bank) monetary policy has been too expansionary; if anything, Sweden's inflation has been too low. Nor is there any indication that international investors have fled Swedish assets over the past decade for fear of a real estate and/or banking crisis in Sweden.

On the other hand, some of the Riksbank's and the Swedish National Debt Office's foreign exchange transactions (which are not part of monetary policy, but rather have to do with the two agencies' portfolio management) may have weakened the krona in recent years. Since 2015, these two agencies have sold several hundred billion Swedish kronor for foreign currency, which has probably weakened the krona, although it is unclear by how much. Furthermore, some private investors have borrowed money in Sweden at a relatively low interest rate to invest in the United States at a higher interest rate, which has weakened the krona. In addition, there are investors who try to follow trends in the foreign exchange market by short-selling kronor when they predict that the krona is going to depreciate and buying kronor when they think it is going to appreciate. Such strategies tend to reinforce already existing trends, but not start any trends on their own.