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PRESS RELEASE

New Nordic Outlook: US recession, European slowdown and more interest rate cuts

The financial market crisis is changing shape. Liquidity problems are increasingly giving way to a credit crunch that hampers consumption and investments. This will create a new wave of problems with traditional cyclically related credit risks. No country will be unaffected, but the ability of fast-growing economies to resist this trend will sustain global growth. The United States is entering a mild recession, and the slowdown in Western Europe will become more apparent. The inflation problem will thus lose strength. US interest rate cuts will continue, and the European Central Bank will follow suit once the slowdown in growth overshadows upside inflation risks. The deceleration in the Swedish economy will become more evident as domestic demand cools. Job growth will gradually fade and unemployment will begin climbing in the autumn. By mid-2008 both lower growth and a more favourable inflation outlook will pave the way for lower interest rates. The Riksbank will then cut its repo rate, bringing it down to 3 per cent some months into 2009. Meanwhile the Swedish government will make greater use of its existing budget wiggle room.

The adjustment processes are under way. A combination of tighter credit conditions, falling home prices and a weaker labour market is generating a negative growth dynamic that will tip the **American economy into recession during 2008**. GDP growth will reach only 0.9 per cent this year. The Federal Reserve will continue to prop up the economy with cuts in its federal funds rate to 2 per cent by mid-year. This, combined with an expansive fiscal policy, will help the economy recover somewhat during 2009.

The slowdown in Western Europe will become more apparent. GDP growth in the euro zone will halve from 2.6 per cent last year to 1.3 per cent in 2008. Worries about the trend of inflation will gradually dissipate, helping persuade the European Central Bank to cut its refi rate to 3.0 per cent by the spring of 2009.

The Fed's aggressive interest rate cuts and the deepening slump in the American economy will continue to weigh down the **dollar** for another while. This spring, its exchange rate **will bottom out at 1.54 per euro**. The focus will gradually shift to the economic weakening in Western Europe and the ECB's interest rate cuts, as the end of the Fed's rate-cutting cycle begins to loom ahead. The dollar will then gradually recover to 1.40 per euro.

After an export-led deceleration last year, the Swedish economy is now weakening on a broader front. Exports are continuing to lose momentum, and the slowdown in domestic demand is becoming more evident. **GDP growth will be less than 2 per cent both in 2008 and 2009.** Two years of clearly below-trend growth will have an ever-clearer impact on the labour market. Job growth will stagnate during the course of 2008, and unemployment will climb from 4.4 per cent this year to 5.0 per cent in 2009, measured as annual averages.

Inflation will culminate during the summer, then fall as energy prices decline and labour cost pressure fades. Sweden's Riksbank will begin a rate-cutting cycle in July. Some months into 2009, its repo rate will stand at 3.0 per cent. Due to the uncertain global environment, the krona will remain weak against the euro for another while, before cautiously recovering to 9.10 per euro by the end of 2009.

Public sector surpluses and weaker economic conditions will give the Swedish government more wiggle room, allowing further fiscal stimulus measures as the 2010 parliamentary election approaches. Combined with the great cyclical sensitivity of the budget, this will **weaken public saving to ½ per cent of GDP in 2009.**

Key figures, Swedish economy
Year-on-year percentage change

	2006	2007	2008	2009
GDP, adjusted for work days	4.4	2.8	1.8	1.7
Unemployment, %, old definition)	5.4	4.6	4.4	5.0
Unemployment, % (EU definition)	7.0	6.1	6.0	6.6
CPIX (underlying inflation)	1.2	1.2	2.6	1.9
Public financial saving (% of GDP)	2.2	3.2	2.2	0.5
Repo rate (December)	3.00	4.00	3.25	3.00
Exchange rate, EUR/SEK (December)	9.03	9.43	9.30	9.10

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