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PRESS RELEASE

Nordic Outlook: Fiscal and monetary shock therapy – but recovery will take time

In the wake of the financial crisis, a dramatic weakening of economic activity is occurring. This decline is global and synchronised. Global GDP will shrink this year, and 2010 will be another typical year of economic weakness. The consequences will be rapidly rising unemployment and mounting tensions in international economic policy cooperation. The threat of deflation will become increasingly evident to the world's central banks, which will respond with zero interest rate policies and quantitative stimulus measures. Highly expansive fiscal policies will soften the downturn, but meanwhile public sector deficits will be driven up to high levels. A stabilisation of output and the global credit market situation will occur towards year-end, but the recovery will be sluggish.

The Swedish economy hit a wall late in 2008 as world trade collapsed. In 2009 GDP will fall by nearly 2½ per cent – the largest downturn in a single year since the Second World War. The economic downturn will persist during 2010 and growth will end up around zero. The labour market will deteriorate and payrolls will shrink by a total of more than 200,000 people. Inflation will ease noticeably. This year the Consumer Price Index will fall by more than ½ per cent. Due to a clear deceleration in the rate of pay increases, inflation will remain far below the Riksbank's target at the end of 2010. Combined with continued downside risks to growth, this will lead the Riksbank to go the full distance and cut its repo rate to zero per cent. Sweden's public sector finances will deteriorate at a rapid pace, and the 2010 budget deficit will be equivalent to 6 per cent of GDP.

The United States will experience its deepest post-war recession. The economy is now going through a sharp savings adjustment, and GDP will fall 2.6 per cent this year. In 2010, too, growth will be far below trend. The upturn in unemployment to more than 10 per cent will be the most dramatic in modern times. Meanwhile the government is launching unprecedented economic stimuli. Zero interest rates, combined with various types of quantitative stimulus measures, are being used in response to the threat of deflation and the difficult credit market situation. Fiscal policy will also be extremely expansive, with stimuli equivalent to 6 per cent of GDP in the next couple of years.

Economic conditions in Western Europe have weakened greatly in recent months, and growth will end up on a par with the US level this year. Delayed policy responses and major imbalances in the housing market in many countries will contribute to this. Large exposure to crisis-plagued Central and Eastern Europe is also weighing down the region. Because of the weak growth outlook and sharply falling inflation, the **European Central Bank will also cut its key interest rate to 0.5 per cent**.

Emerging economies such as China, India and Russia are also being affected as demand from the US and Western Europe falls and the flow of credit dries up. This year, overall GDP growth in countries outside the OECD will be only 1 per cent, compared to the record year 2007 when growth exceeded 8 per cent.

During 2009 the foreign exchange market will focus on the problems in the euro zone, and the euro will **continue to weaken towards USD 1.15** late this year. Key interest rates of close to zero and a continued flow of weak economic data will help push down long-term yields during 2009. Ever-larger public sector borrowing requirements will gradually have an impact on market interest rates, which will rebound during 2010.

The Swedish economy will decline by about the same as the rest of Europe. This year GDP will shrink by 2.4 per cent, and growth will reach only 0.4 per cent in 2010. The labour market is facing a clear adjustment. Unemployment will climb to an average of more than 10 per cent in 2010. The dramatic weakening of the labour market will squeeze wages and salaries. This will help keep underlying inflation pressure very weak, and inflation will end up well below the Riksbank's target at the end of next year. With inflation risks on the downside and a very weak economic situation, the Riksbank can continue helping the economy with interest rate cuts. As early as this spring, the repo rate will stand at zero per cent.

The Swedish government will implement further fiscal stimulus measures next year. Combined with the effects of the economic slump, this will greatly weaken public finances. The public sector's financial saving will move from a surplus of 2 per cent of GDP in 2008 to a deficit equivalent to 6 per cent in 2010. Central government debt will start to climb, after shrinking almost uninterruptedly since the mid-1990s.

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

	2007	2008	2009	2010
GDP, adjusted for work days	2.7	0.3	-2.3	0.1
GDP, actual	2.5	0.6	-2.4	0.4
Unemployment (%, ILO definition)	6.2	6.2	8.6	10.2
CPI inflation	2.2	3.4	-0.7	0.4
Public financial saving (% of GDP)	3.7	2.2	-2.5	-6.0
Repo rate (December)	4.00	2.00	0.00	0.00
Exchange rate, EUR/SEK (December)	9.43	10.92	10.00	9.75

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