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PRESS RELEASE

Nordic Outlook: Recovery while awaiting exit policy

Governments and central banks seem to be drawing a sigh of relief. The world is now catching its breath before the second lap of a tough long-distance race. Exceptional stimulus measures have served as a successful counterweight to a powerful recession and credit crunch. We expect GDP growth in the 30 OECD countries to be close to their trend levels in 2010-2011. China is "guaranteeing" the world that its economy will grow at the 8-9 per cent target rate but needs continued stimulus. Unemployment in most countries will peak in 6-9 months, earlier and at a lower level than in our September forecast. The risk of "printing press inflation" is being exaggerated. The United States and the euro zone will raise their key interest rates cautiously in the autumn of 2010 from extremely low levels, once the risk picture has become more symmetrical. But this does not mean the world is back to business as usual. Economic growth will not suffice to generate new jobs at the desired pace, despite the impact of burgeoning government debt and grotesquely large central bank balance sheets, which need to be reduced.

Sweden is well-positioned both in the short and long term – strong fundamentals pay off. GDP growth will end up at 2.5 per cent in 2010 and at 2.8 per cent in 2011 (in calendar-adjusted terms), somewhat above trend, thanks to the government's stimulus measures and an economy that has been influenced to an especially high degree by ultra-expansive monetary policy. Unemployment will level off at around 10 per cent next summer. We expect collective pay agreements of close to 2 per cent next year, which hardly poses any inflationary threat – productivity will rebound. The Riksbank's interest rate policy will be influenced by future banking regulations and by additional fiscal stimulus, which we expect regardless of the political colour of the government that takes office after the September 2010 election. The first repo rate hike will come in the spring, and we expect the key rate to be 2 per cent at the end of 2010 and 3 per cent at the end of 2011. The low interest rate environment will thus persist.

"The effectiveness of expansive economic policies will be sufficient to provide positive global growth surprises in 2010," says **Håkan Frisén**, SEB's Head of Economic Research and editor in chief of *Nordic Outlook*. "Granted that stock market curves, confidence indicators and inventory effects can be deceptive, but as long as stimulus policies remain in place, the recovery is likely to continue, fuelled by continued optimism in financial markets."

"But the recovery may still derail," says **Robert Bergqvist**, SEB's Chief Economist. "We still do not know how self-sustaining economic growth will be, beyond inventory effects and targeted government support. In 2011, growth risks will be on the downside. There is great uncertainty about the shape and impact of exit policies. The need to shrink super-sized government and private sector debts around the world will also hobble economic performance. There is also uncertainty about how changes in financial sector regulations will affect lending by banks," Mr Bergqvist says.

The unconventional policies of central banks are creating worries about monetary inflation, especially in an environment of growth curves that are cautiously pointing upward again and of inflation pressure from commodities.

"Underlying inflation will continue downward in Europe and the US, driven by low resource utilisation, decelerating pay increases and rebounding productivity," says **Tomas Lindström**, monetary policy analyst at SEB Economic Research. "The money supply circulating in the real economy has not risen in the past year despite monetary expansion. And above-trend growth will be needed in order to boost inflation pressure. Inflation is low while asset prices are moving upward, which may soon pose a dilemma for central banks. This will increase the pressure on central banks to focus more attention on the risk of new financial imbalances. But key interest rates will probably not need to be raised especially much in order to have a restraining effect. Earlier estimates of neutral interest rates are probably too high," Mr Lindström says.

The US economy is under heavy strains, but large-scale stimulus policies are in place.

"We are admittedly seeing a cyclical bottom and greater stability in the real economy and financial markets, but there are still major problems," says **Mattias Bruér**, US analyst at SEB Economic Research. "Stimulus measures are contributing greatly to decent growth, but this effect will fade. Unemployment will peak at 11 per cent, and there is heavy downward pressure on wages and salaries. Meanwhile small banks are not yet on firm ground, which is hampering credit growth. The Federal Reserve is in no rush to raise its key interest rate – it will take the first step late next year," Mr Bruér says.

Sweden may soon show a growth rate that is rather high in an international perspective.

"Strong fundamentals pay off, especially in the Nordic countries. Many countries must formulate exit strategies in the near future and tighten their belts to stop excessively rapid deterioration in government finances. Here Sweden has a relatively good starting position," says **Daniel Bergvall**, government finance analyst at SEB Economic Research. "Unemployment will climb by 3.5 percentage points, which will of course have repercussions on central government finances. But budget deficits will end up at 2.5 per cent of GDP both in 2010 and 2011, which is a low level in international terms, and central government debt will increase to 'only' 40 per cent of GDP. A change of government will not alter this forecast to any great extent," Mr Bergvall says.

Consumer Price Index (CPI) inflation in Sweden will increase somewhat over the next six months, but underlying price pressure will be pushed downward by such factors as historically low resource utilisation, higher productivity, a stronger Swedish krona and an increased likelihood of falling food prices.

"Although we are a little more optimistic about economic growth and the labour market, we are not especially worried about inflation in Sweden. Underlying inflation is admittedly a little higher in Sweden than elsewhere, but this follows historical patterns rather well. We expect a correction as productivity and the krona exchange rate reach more normal levels," says Håkan Frisén. "The Riksbank is actually in no hurry to raise its key interest rate, but our assessment is that it will begin its rate hikes in the spring of 2010, that is, a little earlier than the bank has so far indicated. A brighter economic picture, including a more symmetrical risk scenario and increasingly clear tendencies towards imbalances in the housing market, are reasons for beginning the process a bit earlier than most other central banks," Mr Frisén says.

Group of 20 economists are now in the process of building the "new world economic order" aimed at achieving more balance, stable global economic and financial market performance in the future.

"It is important to monitor the work of the G20, especially considering Sweden's great dependence on international developments," says Robert Bergqvist. "We are moving towards a globalisation of economic policymaking and financial infrastructure. Political influences on the real economy and the financial system will increase in the future. There is a time line for how the G20 countries should work together in the coming years. This is a very positive development, but large portions of the design for the new economic order are still missing – of course this creates uncertainty about the future rules of the game for households and companies," Bergqvist concludes.

Key figures: International and Swedish economy

International economy. GDP, year-on-year change, %	2008	2009	2010	2011
United States	0.4	-2.5	3.0	2.2
Euro zone	0.6	-3.9	1.8	2.1
Japan	-0.7	-5.0	1.8	2.1
OECD countries	0.6	-3.5	2.3	2.4
China	9.0	8.5	9.0	9.0
Baltic countries	-1.0	-15.8	-2.6	3.6
The world	3.1	-1.0	3.9	4.1
Swedish economy. Year-on-year changes, %	**2008**	**2009**	**2010**	**2011**
GDP, working day adjusted	-0.5	-4.2	2.5	2.8
GDP, actual	-0.2	-4.3	2.8	2.8
Unemployment, % (EU definition)	6.2	8.3	9.8	9.9
Consumer Price Index (CPI) inflation	3.4	-0.3	1.2	2.4
Government net lending (% of GDP)	2.5	-1.9	-2.5	-2.3
Repo rate (December)	2.00	0.25	2.00	3.00
Exchange rate, EUR/SEK (December)	10.92	10.20	9.70	9.30

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