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PRESS RELEASE

## **New Nordic Outlook: Ketchup effect for jobs means higher key interest rate**

The Swedish economy is in the midst of a very strong period. GDP will grow by 4.5 per cent this year and 3.5 per cent next year. The labour market is improving sharply, and employment will increase by a total of 170,000 people this year and next. Because of this "ketchup effect" for jobs, the Riksbank will hike its key interest rate to 4 per cent next year, which is more than expected. Meanwhile global growth will stay at a high level for the next couple of years, despite the American deceleration. Inflationary pressure will remain low, but many central banks are continuing to raise their key rates for preventive purposes. These are the conclusions of the new Nordic Outlook, which SEB is presenting today.

The US slowdown has become increasingly apparent, as earlier interest rate hikes have begun to cool off the housing market. Consumption will gradually decelerate. Meanwhile capital spending will show continued strong growth. The US economy will thus experience a soft landing, with growth declining from more than 3 per cent this year to about 2 per cent in 2007. Elsewhere in the world, rising domestic demand will counteract the American slowdown. Growth will remain above trend next year both in **Western Europe** and **Japan**. **China's** powerful economic expansion will continue.

The combination of rapid growth and falling unemployment, on the one hand, and continued low underlying inflation on the other, is complicating life for the world's **central banks**. They have become increasingly inclined to raise their key interest rates for preventive purposes without awaiting clear inflation signals. Their motives are concern about both rising asset prices and the future impact of an ever-stronger labour market on inflation. The **European Central Bank** will continue to hike its refi rate, which will peak at 4.0 per cent next year. In the US, late-cyclical inflation threats will continue to predominate in the short term, but the economic slowdown will gradually take the upper hand and the **Federal Reserve** will begin a rate-cutting cycle by summer. Due to rather tougher central banks than market expectations, bond yields will rise somewhat in the short term, but will then move sideways.

The **Swedish economy** is growing on a broad front, and employment has now taken off in earnest. This year 80,000 new jobs will be created and next year 90,000. Resource utilisation is rising at a fairly rapid pace. The downturn in unemployment will slow somewhat, however, due to the new non-socialist government's steps to boost labour supply. Registered **unemployment** will still fall from 5.4 per cent this year to 5.2 per

cent in 2007, continuing downward towards 4 per cent in the course of 2008. Total unemployment will fall even faster, and equilibrium unemployment will be reduced in the long term.

The 2007 wage round will reflect a stronger labour market. Pay increases will be ½-1 percentage points higher than during 2004-2006. Rising pay increases will intensify domestic inflationary pressure. UNDI<sub>X</sub> inflation will nevertheless stay below the Riksbank's target throughout our forecast period.

Due to rapidly rising employment, the Riksbank will still continue its rate hikes for preventive purposes. Next autumn, the repo rate will stand at 4 per cent. This is above the market view but still in the lower portion of the interval that the Riksbank regards as neutral. The krona will strengthen further.

Fiscal policy will be weakly expansive both this year and next. Various austerity measures will probably be delayed, but public sector financial savings will remain above the official target, which is 2 per cent of GDP.

**Key figures in the Swedish economy**  
**Year-on-year percentage change unless otherwise specified**

|                                     | 2005 | 2006 | 2007 | 2008 |
|-------------------------------------|------|------|------|------|
| GDP, adjusted for work days         | 2.9  | 4.5  | 3.5  | 2.4  |
| Unemployment (%)                    | 5.9  | 5.4  | 5.2  | 4.5  |
| UNDI <sub>X</sub> inflation         | 0.8  | 1.2  | 1.1  | 1.5  |
| Public financial savings (% of GDP) | 2.8  | 3.3  | 2.5  | 2.1  |
| Repo rate (% , December)            | 1.50 | 3.00 | 4.00 | 4.00 |
| Exchange rate, EUR/SEK (December)   | 9.39 | 9.00 | 8.90 | 8.80 |

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